The ANTITRUST BULLETIN

In This Issue

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Table of Contents

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38

EFFECTIVE AS OF THIS ISSUE,

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Author, "The Joint Venture and Tax Classification" and "Copyright and Antitrust"

HAS BEEN APPOINTED EDITOR OF THE ANTITRUST BULLETIN

On the following page appears the introductory letter from our editor.

Federal Legal Publications, Inc.

Dear Reader:

More than six years ago, the Antitrust Bulletin pioneered as the first professional *periodical* in the United States devoted exclusively to antitrust and trade regulation. Much has happened since then, and interest in these subjects has mushroomed. With it all, the Antitrust Bulletin continues as the bellwether of legal publication in its field.

More than ever one asks, what is it all about, what does it mean? Existing services now amply fulfill the journalistic function of dissemination of current news and information. We are therefore replacing the Antitrust Newsletter with a "News and Views" section which will feature one or more by-lined commentaries wherein authors may "sound-off" on any relevant issue, subject to editorial responsibility. "News and Views" will also include documents, addresses, statements and miscellany of interest, as well as occasional rulings or opinions which might not otherwise come to the reader's attention. Other changes of format, as well as of type, are in contemplation.

We shall continue to publish articles of all kinds—learned, practical, symposia, addresses, legal, economic and so on. At times we hope to achieve perspective in depth on important matters of the day. In other issues, variety and scope will be evident. We have been and will continue to emphasize new developments in international antitrust, such as the Common Market. Books will be reviewed regularly and often.

Increasingly our material will be original, but not necessarily exclusively so, because we shall not eschew the exceptional that merits republication. Above all, we shall maintain the policy of objectivity and nonpartisanship of the Bulletin. We wish to provide our readers with the best of a diversity of expression on many, many subjects of importance. To that end, we welcome and invite the comments, criticisms and suggestions of our readers so that the Bulletin may continue to serve as the first and foremost American antitrust periodical.

Joseph Taubman
Editor

THE CORPORATION AS A POWER NEXUS

by

LEE LOEVINGER*

Although the struggle among individuals and groups for power is one of the oldest, most pervasive and most important social problems, it presents itself in new forms and new contexts today. In the earliest stages of development, man sought principally power over the environment in order to provide himself with food and shelter. We still seek instruments that will give us greater control of the forces of nature. However, as elemental needs for food and shelter have been more nearly satisfied, the struggle for power has turned into a competition for the ability to control others, either through the use or threat of physical force or through some form of social organization.

There are many approaches to a study of the problems of power and its organization, and each has something to contribute to our understanding. One of the most practical and illuminating methods of studying present institutions of power and seeking guides to the future is to analyze the history of such institutions. Fortunately this is relatively easy with respect to the corporation and related legal and economic institutions, as these have been developed within historical and rather recent periods.

American corporation law began its development in England under the feudal system. At that time the principal source of economic productivity, wealth and power was land; and the political as well as the economic power system was based upon land tenure. Under this system, political and economic power were essentially the same, and were held by the same persons.

* Assistant Attorney General of the United States in charge of the Antitrust Division of the Department of Justice. This is an edited version of a speech delivered at a lecture series sponsored by the University of California at Los Angeles on October 11, 1961.

The feudal system as an organizational structure for both political and economic power was superseded, and finally destroyed, by a series of related developments that are sometimes rather casually lumped together as the industrial revolution. These encompass a group of intellectual, scientific and technological advances that, within a few centuries, have vastly increased man's abilities in transportation, communication, production, research and tilling of the land. When agriculture ceased to be the only important productive economic activity the feudal system was replaced by the mercantile system. At the same time, changes in man's philosophic and religious viewpoints were producing new political theories. These held that there was an intrinsic worth in each individual which made him politically the equal of every other individual. It followed from this that the forms of Government itself should limit the concentration of political power and provide more political power for the individual member of society. Thus, powerful impersonal social forces combined with a concomitant change in cultural viewpoint to produce a severance between political and economic power and a considerable dispersion of both.

The consequences of this are apparent in the framework of the American Government. We have one national sovereign government, but it is divided into three separate coordinate and equal branches. It is clear, both from history and from the explicit declarations of the founders, that the purpose of this division of power within the Government was to forestall the abuses thought to arise from a concentration of power and was not to achieve an illusory functional symmetry or efficiency. In addition, under the federal system, the sovereignty of this nation is further divided among 50 State governments and among more than 100,000 sub-divisions of local governments. The nature and the necessity of this system of "checks and balances" as a means of preventing the abuse of governmental power is now widely recognized. However, considerably less attention is usually given to the forms of private power structures and to the checks and

balances to which they may be subject. The institutions that provide the organizational structure for private power are, nevertheless, of the greatest importance; and the corporation is among the most important.

The earliest corporations arose under the common law during the feudal period as organs of government, ecclesiastical or municipal, rather than as business devices. The common law corporation controlled the activities of its members, exercised jurisdiction over them and then negotiated on their behalf with other corporations and with the government itself.

Among the earliest corporations were merchant guilds which were a fundamental feature of the municipal organization in England in the 12th and 13th centuries. The merchant guild was composed of citizens possessing the exclusive right to trade within a borough free of tolls. The function of the guild was to regulate trade so that every member could maintain himself. As in a modern producers' cartel, the standard of guild regulation was thus set by the least efficient economic unit. The relationship of the guild members was quite unlike that of the modern stockholder and the corporation. Until about the 15th century, by the right of "winthernam," an unpaid creditor of any member of a guild might distrain, or hold liable, any other member of the debtor's guild who entered the creditor's town.

The growth of craft guilds resulted in the replacement of a single corporation with a monopoly of trade in its area by a number of corporate bodies each controlling a different trade or group of trades. The craft guild controlled the working lives of its members, they were answerable to it and it answered for them. Although the guild corporation began to decay in the 15th century, it was not until 1504 that a guild member could sue a fellow member without leave of the guild.

In English law, the first associations formed for undertaking to accumulate capital in order to conduct a business were the joint stock companies. The term "joint-stock" was

first used in 1554 by the Merchant Adventurers of Newcastle-on-Tyne. In the second half of the 16th century, many private syndicates were financed by joint-stock subscriptions. The first public subscription for such an enterprise was in 1617 by the East India Company. It raised 1,500,000 pounds for a voyage to the Indies from some thousand subscribers that included noblemen, wives of noblemen, widows, clergymen and merchants. It was granted a monopoly on the right to ship tea to the American colonies. Incidentally, the monopoly price resulted in a wave of resentment which culminated when the patriots of Boston boarded an East India Company ship in Boston harbor and dumped all of the tea into the harbor.

Such a grant of monopoly rights, coupled with the grant of the franchise to be a corporation, was common in the early development of the joint-stock company, although either grant could be made without the other. In the early joint-stock companies, such as the East India Company, participation was by membership, as it was in the early corporations. Thus, each member had one vote, regardless of the amount of financial participation or joint stock held, the right to vote was personal, and it could not be delegated or exercised by proxy. The right to vote was also regulated in many cases by legislation in much the manner of the modern political franchise. For example, by an act of Parliament in 1767, no member of a joint-stock company who held shares for less than six months could vote.

In the 17th and early 18th centuries, there was a great company promoting boom in England which came to be known as the "South Sea Bubble." This was a broad bull market in joint-stock trading stimulated in part by the flow of many new company stocks. Many of the companies were ill conceived and some were downright fraudulent. The laws regulating the rights of investors and promoters were uncertain and inadequate. There was general protest against the abuses of indiscriminate stock promotion and in 1719, Parlia-

ment passed the "Bubble Act." This was, in effect, a flat prohibition on the formation of any new joint-stock company.

In England, following passage of the Bubble Act, groups associated together for business purposes in partnerships and chartered companies. Associations comprising 2,000 or more partners were not uncommon. In a period of a few years, Parliament passed 65 special acts for incorporation of fire insurance companies. A device for the formation of associations with limited liability developed at this time was the "cost-book company." These were partnership companies in which a purser kept accounts and presented the cost book at regular meetings of the company, usually once a month. If an enterprise became unsuccessful, a member might withdraw and was not liable to lose any more than he had previously paid in to the company.

In 1811, in the case of *Rex* v. *Webb,* 14 East 406, the House of Lords held that, despite the Bubble Act, a company could act as though it were a corporation provided it had an object purely beneficial to the public, such as the supply of food or necessary services. Thus, the prohibition against corporate group action was subject to a rule of reason similar, in many respects, to the rule of reason modifying the prohibition against contracts in restraint of trade.

The Bubble Act was finally repealed in England in 1825 and the Crown was authorized to grant a charter of incorporation accompanied by such limitation of liability for stockholders as might seem appropriate in each case. This legislation was not very successful and in 1834 Parliament enacted the Trading Companies Act which recognized the existence of numerous unincorporated joint-stock companies, and empowered the Crown to grant the privileges that could be conferred by charter of incorporation by letters patent to trading and other companies. It also provided that the liability of a member of one of these companies should cease three years after the date on which he transferred his shares. This Act also was not widely used, and in 1837 Parliament

enacted the Chartered Companies Act which empowered the Crown to incorporate companies by letters patent and to limit the liability of members to a fixed maximum for each share. This was superseded by the Joint-Stock Companies Act of 1844, which provided for the registration and incorporation of joint-stock companies. These were defined as every partnership with shares transferable without the consent of the co-partners, and as all partnerships with more than 25 partners. The Act laid down a code of internal management for companies and for relations between shareholders, but it did not recognize limited liability except for one who had ceased to be a shareholder three years before the action.

Limited liability was first recognized in England by an act of 1855, which provided that shareholders should be liable only to the amount not paid up on the shares subscribed. This also required that companies having such a limitation must include the word "Limited" as the last word in the name of the company. This Act was shortly superseded by the Joint-Stock Companies Act of 1856 which clothed the joint-stock company in modern dress. The 1856 legislation repealed the earlier acts and fused the equitable company with the common law company. Seven or more persons were authorized to form an incorporated company, with or without limited liability, by subscribing a memorandum of association and complying with the formalities of registration. Partnerships of more than 20 persons were treated as corporations, and corporations with less than seven shareholders were treated as partnerships. Liability could be limited to the amount unpaid on shares held by the shareholder. The law has been rewritten and codified in subsequent legislation but the basic principles have remained. The principal significant innovation was introduced in 1907 when legislation gave statutory recognition to the distinction between the private company, which made no offering of its shares to the public, and the public company which did make such an offering.

Thus, at the time that the United States inherited the common law from England, the private business company, as we know it today, had no recognized legal status. However, the privilege of incorporation was established earlier in the United States than in England. In 1788, the State of Virginia, and in 1798 the State of Kentucky, provided for the incorporation of fire insurance companies. In 1799, Massachusetts provided for the incorporation of water companies. A more general act permitting the incorporation of business concerns was passed in New York in 1811. This permitted the formation of corporations for manufacturing purposes with capital of not more than $100,000, for a period of 20 years by the filing of a certificate with the Secretary of State.

The first general legislation authorizing incorporation was passed by Massachusetts in 1830 and this was shortly followed by a similar act in Connecticut in 1832. Thereafter, similar legislation was passed by all of the states. Such legislation followed the practice of New York in allowing incorporation by the filing of a certificate in proper form, stating the amount of fully-paid stock and limiting the liability of stockholders to the amount subscribed for the stock held by them.

In this country both the Federal and the state governments possess and have exercised the right to create corporations. The Federal Government early exercised its authority to establish corporations in setting up the Bank of the United States. The first Bank of the United States was chartered by the Federal Government in 1792. Congress refused to renew its charter in 1812, but in 1816 established the second Bank of the United States which functioned until 1836. Following the Civil War, the Federal Government chartered a number of railroads. In more recent times, the Federal Government has chartered national banks and a number of Federal corporations such as the R.F.C. and T.V.A. In general, however, the authority to create corporations has been exercised by the state governments in this country, and

practically all the business corporations of the United States (except national banks) operate under the authority of state law.

In any event, by the latter part of the 19th century, the right of a group of persons to associate together, to establish a legal entity capable of acting in a single name fixed by law, and to have succession in the entity and limited liability in the individuals, was established in both England and the United States. Such organizations were commonly known as corporations in the United States, but have continued to be known as joint-stock companies in England. In this country, however, the distinction between corporation and company has not been observed and the two terms are often used interchangeably. It is interesting to observe that the term "company" indicates the origin of these groups since it means an association of individuals in pursuit of some common object and is derived from Latin roots meaning "together" and "bread." Thus, the word "company" itself indicates a taking of meals together, which was a characteristic of the earliest groups of this kind.

Most of our state corporation laws have been amended and developed to fit the business needs of an expanding and changing economy during the twentieth century. Modern state corporation laws permit the formation of business corporations for almost any purpose, with unlimited capital and with perpetual existence. There are a variety of special laws applying to such enterprises as banks and financial institutions, insurance companies, public utilities, cemeteries and other specific types of economic activity. In addition, nearly all states have special laws applying to cooperative corporations, social groups, religious bodies and non-profit or charitable corporations. The corporation has become an extremely versatile, flexible and adaptable legal device in modern America.

Economically the corporation has grown to a dominant place in our society. As of the beginning of 1961 there were

some 4,700,000 business firms in operation. However, counting all sole proprietorships engaged in commercial activity, all partnerships and all corporations there were more than twice this many, or over 10,000,000 entities engaged in some business activity. Specifically there were about 8,800,000 sole proprietorships, about 950,000 partnerships, and just under 1,000,000 business corporations.

But the business corporation is clearly the favored and predominant form. The 8,800,000 sole proprietorships had total business receipts of about 160 billion dollars, while the 1,000,000 business corporations had business receipts of about 700 billion dollars. Of course, within the group of 1,000,000 corporations there is a wide disparity in size and considerable concentration of assets and income. In manufacturing, for example, the value added annually by the largest 50 corporations is 23% of the total, by the largest 100 corporations is 30% of the total, and by the largest 150 corporations is more than one-third of the total of the value added by all corporations. The 200 largest non-financial corporations in the country control over 55% of the assets of all corporations, which amount to a total of over 287 billions of dollars. Less than 115 corporations own approximately one-half of the total assets employed in manufacturing. In at least 150 separate industries, four companies produce more than one-half of the total shipments in each industry. Looking at the country as a whole, at least two-thirds of the economically productive assets of the United States, excluding agriculture, are owned by less than 500 corporations. In addition, interlocking directorates, holding companies, and common control through investment bankers increase this concentration of power to a degree which is presently unknown.

Taking the criteria promulgated under the Small Business Act (15 U. S. C. §631 et seq.), 98% of all the businesses in operation in this country are small business. Of the remaining 2%, about 1.9% or more may be considered as medium size business, and less than .1% as big business. Most of the sole proprietorships and partnerships are small

business, and most corporations also fall into this category. On the other hand, all of the big businesses are corporate in form.

There is another aspect to the corporation as an economic institution that must not be overlooked. While it has served as an instrument for aggregating capital, permitting the undertaking of large enterprises and the establishment of vast integrated economic holdings, it has also tended toward the distribution of the profits of economic activity among a relatively large group. Although precise figures are not known, it is estimated that there are between 10,000,000 and 15,000,000 corporate shareholders in the United States today. There may very well be some inflation of this figure by virtue of one individual or members of a single family owning shares in a number of corporations. On the other hand, a great many more individuals have indirect interests in corporate shares through interests in pension funds and similar institutions.

Furthermore, there are a number of devices, such as mutual funds and profit-sharing plans, which are constantly increasing the number of shareholders and the ownership base of corporate stock. The first profit-sharing plan was set up in this country in 1887 by Procter & Gamble Manufacturing Company and has been in continuous operation since that time. The largest in the country is probably that of Sears, Roebuck & Company which was started in 1916. Not all profit-sharing plans provide for the acquisition of stock by employees, but the majority of them do and it was recently reported that 20% of the companies listed on the New York Stock Exchange now offer some form of stock acquisition plan for their employees.

While these plans may help to distribute the economic benefits of greater productivity, they may result in either concentration or diffusion of the power of control depending upon the manner in which they are set up. Thus, it was reported that a plan recently agreed upon between American

Motors Corporation and the United Auto Workers Union provided for a profit-sharing plan by which 5% of the company's profits would be invested in a fund to be held for the benefit of the employees. This fund will be invested in stock of the company which will be voted by trustees selected by the company's board of directors. The effects of such a plan are obvious. Over a substantial period of time, the corporation must either dilute the equity of other shareholders or permit the Board of Directors ultimately to acquire voting control of a majority of the stock of the company.

Such plans challenge us to consider the manner in which corporations have operated in the organization of economic power. The classical study of this matter was by Berle and Means almost thirty years ago. This concluded that power—effective control of the vast corporate wealth—was highly concentrated both in a few corporations and within the corporations in the hands of a small group of executives, rather than in the owners or shareholders. More than 25 years later Berle has again repeated these conclusions, asserting that the concentration of economic decision-making power in and within the 500 largest American corporations is "the highest concentration of economic power in recorded history . . . it makes the medieval feudal system look like a Sunday School party. In sheer economic power this has gone far beyond anything we have yet seen."

Despite the body of underlying data this conclusion seems to lean toward hyperbole. Surely the autocrats of history, the oriental despots, the Pharaohs, the Czars, the Zaibatsus, and, more recently, the fascist and communist dictators, have had great concentrations of economic as well as political power. Undoubtedly there is greater economic power in the sense of a greater accumulation of wealth in the United States than ever before has existed in history. But it is dubious that there is a greater degree of concentration of such power than ever before in history. Perhaps the difficulty is that we have no direct method of measuring or comparing economic power. We may take corporate holdings of

assets as a rough indication of economic power; but we have no accurate means of determining how power is distributed within a large corporation. There is some indication from observation that the more widely distributed the stock of a corporation, the smaller the proportion required for control and the more concentrated the actual control of the corporation is likely to be. There is no quantitative measure or expression of this principle, if it is true; and we have no valid basis for comparing economic power in wholly dissimilar historical societies. Indeed, the concept of power itself is a highly abstract idea in this context and may apply to many varied economic relations. A meaningful analysis or comparison of situations requires some specification of the kind and degree of power that is involved in the ownership or the control, respectively, of corporate assets.

In any event, it is not yet established that there is anything inherent in the corporate form itself which either creates economic power or causes it to be highly concentrated. The economic power of this country in this century is the result of the development of instruments of communication, transportation and production that were created by the scientific, technological and industrial revolutions, and were not the result of legal forms or institutions. If there were no corporations, it seems highly probable that there would still be economic power and that it would exist in about the same degree of concentration observable now. Indeed, it is quite possible to conceive of a social order with no corporations but with essentially the same concentration of economic power that presently exists. Historically there have been numerous variants of the business association which have served the same purpose as the modern business corporation. Although none of them seems as well adapted to the function of permitting free and flexible economic development, several other legal forms could serve to institutionalize contemporary business activity.

It should also be noted that very substantial amounts of economic power are held in the contemporary order by gov-

ernment, by labor organizations and by individuals. Labor unions not only have found no need for incorporation but, by and large, have avoided the corporate form during the period of their greatest increase in economic power.

Both historically and analytically, the corporation seems to be less a source of economic power than a form or device for organizing economic power, a means of connecting various persons with economic power, or a power nexus.

Historically the early English corporation was identified with monopoly, but this was the result of its quasi-governmental character and its operation under a grant from the sovereign which at once conferred its corporate nature and its monopolistic rights. The institution that has developed into the modern business corporation—or company as it is called in England—never possessed such monopolistic privileges in this country and has long since lost them in England.

In any event, in this country at least, concomitantly with the development of the corporation we have established laws to limit the undue concentration of economic power. The antitrust laws, conceived and enacted in the 19th century, have been consistently construed and applied in the 20th century as a means of preventing and forestalling monopoly, which is roughly defined in terms of undue concentration of economic power. The antitrust laws are not limited in their application to corporations, but forbid monopolizing or restraint of trade equally to individuals, partnerships, informal associations and any others engaged in business activity. It is probably a tribute to the utility of the corporation that most antitrust actions are against corporate defendants. Traffic officers are found on a busy thoroughfare, not on a deserted country lane. Similarly, economic traffic officers, the antitrust lawyers, are found where there is economic activity, not where there is economic stagnation.

While the antitrust laws are the principal defense in this country against undesirable concentrations of economic power, they are by no means the only important forces act-

ing in this area. The government itself, in other policies and activities, has an important influence toward either more or less concentration of economic power. The government either promotes or tends to prevent economic concentration by the policies it follows in procurement, by activities in fiscal management, by tax rules and policies, by direct regulation of various industries, by controlling entry into particular fields, and by a host of laws and activities that either help or hinder the birth and growth of small businesses, labor unions, cooperatives and other organizations. Scientific inventions and technological developments undoubtedly exert powerful economic influence, sometimes creating or strengthening, sometimes weakening or destroying entire industries. Finally, public opinion itself is, both directly and indirectly, an influential force in the course of economic development.

As the corporation is an instrument, a vehicle, a means, rather than a prime cause of economic power or activity, it may be used to distribute power or organize it democratically among a large group, as well as to concentrate it. The importance of the corporation in our society suggests that its structure, functioning and organization as an institutional power nexus deserves more study and critical examination than it has heretofore received. The present form of the corporation and the distribution of economic power in society are both clearly the product more of historical evolution and accident than of conscious design. However, evolution is not a closed chapter in a completed history; rather it is a continuing story in which present participants are both actors and authors.

It has on occasion been urged that government should emulate business methods. It might be appropriate to consider the possibility that modern business organizations be patterned in some respects, after government. It might prove advantageous to both business and the general public to seek means to strengthen the democratic structure of the giant corporation so that a system of internal checks and balances

analogous to those of the governmental system would share with external controls the task of preserving economic enterprise in a democratic society free of socialization and of private abuses alike.

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THE IMPLEMENTATION OF THE ANTITRUST RULES OF THE EUROPEAN COMMON MARKET TREATY

by

George Nebolsine*

Introduction

Though the Common Market Treaty came into effect on January 1, 1958[1]—over four years ago—there has been comparatively little application of its antitrust clauses in specific cases either by the European Economic Commission or by the member states. One of the reasons for this has been the delay in issuing implementing regulations. The delay in the issuance of the Regulation arose in part from the differences of antitrust philosophy that exist within the Common Market Community and the difficulties of formulating a Regulation that would have the support of all Member States.

The Rules of Competition of the Common Market take a sterner view of cartels than do the national laws. Cartels that may interfere with the creation of a Common Market by allocating national markets among producers or fixing prices are particularly singled out for suppression.[2] Restrictive practices condemned are those "likely to unfavorably[3] affect trade between member states and prevent, restrict or distort competition within the Common Market." Examples of restrictive practices are contained in both Article 85 and Article 86,[3a] but this list is not complete.

A close study of these provisions emphasizes the difficulty of determining what exactly is prohibited. The two opera-

* Coudert Brothers, New York City. This article is based on a speech delivered before the Association of the Bar of the City of New York.

1 The Rome Treaty can be found in its four equally authentic texts in *Bundesgesetzblatt Teil II,* 1957, No. 23.

2 EEC Second General Report, para. 111.

3 OEEC Guide, EEC Treaty, Commentary. See discussion of official texts on this point.

3a See Appendix at A.

tive conditions are (a) that the practice is likely to unfavorably affect trade between Member States and (b) that it would prevent, restrict or distort competition within the Common Market. These two conditions are no mere formalities, but must be shown to be fulfilled by the suspect practice and the burden lies on the Commission to establish these facts.

I. *Regulation No. 17*

Regulation No. 17 of the EEC providing for the implementation of the antitrust rules contained in Articles 85 and 86 of the Rome Treaty became effective on March 13, 1962.[4]

Under this Regulation, the EEC Commission has acquired extensive powers of investigation and inquiry into European industry and business generally. It has become the principal enforcing agency, taking this function from the Member States which under the Treaty had been primarily charged with enforcement pending the issuance of a Regulation by the Council of Ministers and has acquired strong sanctions against recalcitrant enterprises. No clarification of the substantive law is to be found in the Regulation. Its chief contribution toward the clarification of the status of restrictive agreements lies in two procedures, neither of which has any parallel in American antitrust practice.

1. *Negative Rulings*

The Regulation sets up a procedure for settling doubts as to the legality of restrictive agreements and the existence of an abuse under Article 86 called a negative ruling. A negative ruling applied for by the interested enterprise states in effect:

> "that there is no ground for the Commission on the basis of the elements brought to its knowledge to intervene in connection with an agreement, a decision or a practice under Article 85(1) or Article 86 of the Treaty."

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[4] Journal Officiel C.E. 21 February, 1962.

It will enable parties to seek rulings on doubtful agreements while reserving their rights to apply for an exemption under Article 85(3). It is anticipated that the forthcoming Rules may permit the two applications to be joined in the alternative. This would permit an enterprise to say in effect: "We don't believe our agreement infringes Article 85(1), but if you find that it does, then we are applying for an exemption under Article 85(3)."

Doubts have been expressed as to the legal value of a negative ruling which will probably not be legally binding on the Member States. However, the fact that the Advisory Committee, composed of representatives of the Member States, is consulted before issuance of a negative ruling may have some value in restraining state action in respect to the agreement in question.

2. *Notification of Agreements*

Another novelty in the Regulation is the provision for the "notification" of agreements to be ruled upon by the Commission under Article 85(3).

The notification, being part of the procedure for seeking an exemption, is technically voluntary. But the whole structure of the Regulation with its provision for penalties for violation of Article 85(1) coupled with the protection it affords those who notify their agreements as prescribed, tends to make it essential for agreements containing doubtful elements.

Existing agreements must be notified prior to August 1, 1962, to enjoy the retroactive immunity from penalties afforded by the Regulation (Art. 5).

In the case of new agreements the date of notification determines the date from which such agreements can be cleansed of illegality under Article 85(3). This in turn will in all likelihood determine the date of applicability of clause 2 of Article 85 which prescribes that agreements prohibited by the Article are null and void.

The agreements notified are protected from fines only to the extent that their restrictive provisions have been disclosed.

A premium is thus placed on making the notification prompt and full and discouraging the parties from waiting to see how the Commission's enforcement program works out.

Exemptions From Notification

The Regulation (Art. 4) exempts from the prerequisite of notification the following classes of restrictive agreements:

1. Between participants belonging to a single Member State and where the agreements "concern neither imports nor exports between the Member States";
2. Between only two enterprises and when the sole effect of these agreements is to set resale prices of merchandise acquired by one party from the other;
3. Between only two enterprises when the sole effect of these agreements is to impose limitations upon the purchaser or the user of rights in industrial property "in the exercise of these rights". The rights involved include trademarks, patents and know-how;
4. Where the object of the agreement is solely to formulate and apply uniform standards;
5. Where the object is solely the common search for technical improvements, if the results are accessible to all the participants.

These exemptions from notification are by no means to be read as giving legal sanctions to the practices involved under Article 85(1); they are merely devices for postponing the consideration of such agreements, which must, however, be notified before January 1, 1964, if they are to enjoy retroactive immunity. As indicated in Art. 22(2), the agreements listed will be the subject of further Regulations within a year.

Comparing the list with an earlier Commission draft of the Regulation, we note that the list of the practices temporarily exempt from notification has been altered by dropping exclusive dealing agreements as well as exclusive representation agreements for products or services. The omission of these very common practices in distribution is significant. It reflects the views of the French national antitrust law which deals very severely with exclusive dealing arrangements and refusals to sell.[5] The upshot of this is that exclusive dealing arrangements involving transactions between Member States are suspect and in most cases will require either notification or an application for a negative ruling under Regulation No. 17 to protect the parties from the risks of penalties for violation of the Treaty.

3. *Exemptions Under Article 85(3)*

Exemptions as noted above are the sole prerogative of the Commission. The exemption procedure is particularly important because in a sense it takes the place of the Rule of Reason in U. S. antitrust practice. Article 85(3) permits "good cartels" and business practices which, though technically restrictive, are economically desirable to be declared legal. The economic tests in Article 85(3) may only be applied by the Commission. The courts of the member states cannot apply Article 85(3).

The economic tests of Article 85(3) that an applicant for an exemption must satisfy are that the agreement or concerted practice contributes "to the improvement of the production or distribution of goods or to the promotion of technical or economic progress." Such agreement, however, must comply with the following conditions:

1. "An equitable share of the profits, resulting from the restriction" must be reserved to users.

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[5] OEEC Guide, France. Transactions involving exclusive dealings are referred to critically in both the Third and Fourth General Reports of the EEC Commission.

2. No restrictions will be approved which are not indispensable.

3. The restrictive agreement must not result in the elimination of competition in the goods concerned.

Moreover, the Commission will grant such exemptions only for a limited period and may impose conditions upon the parties benefiting therefrom.

The exemption procedure will require the submission of considerable detailed economic data to justify the request. This data will be made available to Member States and an Advisory Committee of experts who will review the Commission's recommended ruling as well as the evidence.

4. *Investigations*

The Regulation confers vast powers of investigation upon the Commission.

Firstly, the Commission is authorized to gather what is termed "all necessary information" from enterprises in connection with the enforcement of the Treaty provisions (Art. 11).

Secondly, it is also authorized to make broad investigations. Art. 12 of the Regulation states:

> "If, in an economic sector, the development of trade between the Member States, the fluctuations of price, the rigidity of prices or any other circumstances create a presumption that in the economic sector under consideration competition is restricted . . . "

The Commission may then address questions to all enterprises in the sector.

Thirdly, in the case of enterprises "whose size creates a presumption that they occupy a dominating position . . . in a substantial portion of said market," the Commission may require a declaration "of the particular elements relating to

the structure of the enterprises and to their operations necessary in order to estimate their situation in regard to the provisions of Article 86 of the Treaty" (Art. 12). The scope of inquiries under Article 86 is suggested by its subparagraphs which refer to:

—the imposition of inequitable prices (Art. 86(a)),

—the limitation of production, markets or technical development (Art. 86(b)),

—discrimination in prices and terms (Art. 86(c)), and

—tieing arrangements (Art. 86(d)).

Fourthly, the Commission is given power to verify records of enterprises, taking copies and asking for verbal explanations.

With these powers the Commission can bring to light data which has been concealed from it in notification applications.

These powers in the aggregate greatly exceed those of our law enforcement agencies. They may involve the delving into such trade secrets as costs and prices to all customers' inter-corporate relationships and other matters. The Regulation prohibits the Commission's agents from divulging the information they obtain to unauthorized persons (Art. 20), but leakage of such information will be greatly feared and may create difficulties in carrying out the broader type of investigations and verifications.

5. *Fines*

The Commission may impose fines of from $100 to $5,000 in respect of incorrect statements in applications for exemption or notifications or in answer to inquiries or where incomplete data is presented in connection with verification.

The Commission may impose fines of from $1,000 to $1,000,000 which may be brought up to ten (10%) per cent of the business turnover when an enterprise "deliberately or

through negligence" violates Article 85(1) or Article 86 or acts contrary to the stipulations imposed by the Commission pursuant to Article 8.

The fines may *not* be imposed for acts:

(a) committed after the notification to the Commission and prior to the Commission's decision whereby it grants or denies the application of Article 85, Paragraph 3 of the Treaty, to the extent that such acts are within the limits of the activities described in the notification

(b) committed prior to the notification of the agreements, decisions and concerted practices existing at the date on which the present regulation becomes effective, provided such notification was made within the time indicated in Article 5, Paragraph 1 and Article 7, Paragraph 2.

The Commission is authorized to impose daily fines of $50 to $1,000 per day to compel the termination of a violation of Articles 85 or 86 pursuant to a decision rendered by the Commission or to terminate acts prohibited under Article 8 or for delays in furnishing information requested by the decision under Article 11 or in delays in compliance of verification ordered by a decision.

The importance of the element of good faith on the part of the enterprise charged with violation of the Treaty provisions or failing to notify an agreement under the Regulation is brought out in the wording of the penalty clause, which makes violation committed *"deliberately or through negligence"* punishable.

The Commission may direct an illegal practice to be terminated and fine the parties for disobeying its orders.[6] It may also prescribe the conditions under which an Article 85(3) exemption is granted.[7] Failure to comply with condi-

[6] Reg. Article 15.

[7] Reg. Article 8.

tions so prescribed are punishable.[8] In one case the attempt to impose far-reaching conditions under the ECSC Treaty brought about a controversy and an interrogation in the European Assembly.[9]

There is no provision in the Rome Treaty directed against concentration through stock acquisitions or other forms of concentration.[10] There is therefore no provision for disposal of assets, divestiture or dissolution of enterprises.

6. *Scheme of Proceedings*

The European Economic Commission is the supreme executive body of the Common Market Community. As such it has very extensive functions in conducting the internal as well as external affairs of the Community. The Regulation charges the Commission with responsibility, among others, for

—issuance of negative rulings (Art. 2);[11]

—deciding on the existence of violations of Articles 85 and 86 (Art. 3);

—granting exemptions under Article 85(3) of the Treaty (Art. 6);

—conducting investigations (Arts. 11, 12, 13 and 14);

—imposing fines (Arts. 15 and 16); and

—hearing interested parties (Art. 19).

The Commission will in fact delegate most of these functions to its Department of Competition, headed by a Dutch econo-

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8 Reg. Article 15(2).

9 See discussion in Nebolsine, "Antitrust Laws of the Common Market Countries," *1961 Institute on Private Investment Abroad.*

10 Von der Groeben, "The Cartel Legislation of the EEC in the Light of Two Years' Experience." Frankfurt Institute (1960), *Cartel and Monopoly in Modern Law.*

11 References in parentheses are to Regulation No. 17.

mist and former administrator of the Netherlands antitrust law, Mr. Verloren van Themaat.

Important roles in formal proceedings are also assigned to the Member State and the new Advisory Committee.

Member States

The Commission is enjoined to conduct its proceedings "in close and constant cooperation with the competent authorities of the member states which are empowered to formulate any observations regarding said proceedings" (Art. 10(2)). It may be noted parenthetically that in the first case handled by the Commission on an experimental basis, representatives of the member states sat in on the questioning of the parties and were consulted by the Commission representatives.

The Advisory Committee

The Advisory Committee created by the Regulation, composed of experts from each of the member states, is to be consulted prior to any decision. The consultation takes place during a joint meeting with the Commission. "A statement of the case and indication of the most important documents and a draft of the proposed decision . . . " are to be communicated to the Advisory Committee (Art. 10(5)). The Advisory Committee may submit an opinion. The results of the consultation will form the subject of a written report which shall be attached to the proposed decision (Art. 10(6)).

The role of the Advisory Committee is open to speculation. It could obviously play a considerable role in influencing the Commission's policies in applying the Rules of the Treaty. Its advisory report, however, will not in all likelihood be available to the parties. It is to be anticipated that some of the differences which persist in the point of view toward restrictive agreements and abuse of economic power between the Member States will manifest themselves in the reports of this Committee.

Role of Parties and Intervenors

The Commission can secure information from the parties, as we shall see in reviewing the powers of investigation. The Regulation provides: "Before rendering a decision . . . the Commission shall give the interested enterprises . . . an opportunity to make their views known with respect to the grievances alleged by the Commission" (Art. 19(1)).

Before rendering a negative ruling or a decision on an application for exemption, the Commission shall publish the essential part of the request and invite interested parties to make their observations known (Art. 19(3)). Individuals or corporate entities evidencing a valid interest may ask to be heard and the Commission must accord them a hearing (Art. 19(2)).

7. *The Treaty Rules Become Immediately Effective*

There have been questions, particularly in the Netherlands, as to whether the Treaty Rules of Competition were effective prohibitions or required implementation by regulation.[12] In other quarters the question has been raised whether the decisions on the rules were effective *ex nunc* or *ex tunc.* This is the complex question of whether nullity of an illegal agreement occurs spontaneously at the time the Treaty became effective (January 1, 1958) or when the Regulation becomes effective or at a time prescribed by the Commission. It has been debated without any final consensus.[13] These questions are partially answered in the Regulation, which provides (Art. 1):

> "The agreements . . . referred to in Article 85(1) and the abusive exploitation of a dominant position . . . in the

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[12] The Netherlands law of December 5, 1957, implementing Article 88 of the EEC Treaty provides that no agreement shall be deemed incompatible with the Common Market until this will be announced by the national cartel authorities in the Netherlands.

[13] See discussion in report of the Commission of the Interior Market, European Parliamentary Assembly, Documents 1961-1962, September 7, 1961, Document No. 57, pp. 12, 13.

> sense of Article 86 are prohibited and no previous decision to that effect is necessary . . . "

This lays at rest the doubt that the prohibitions of the Treaty required court action to become effective after the Regulation comes into effect.

8. *Concentration of Jurisdiction in the Commission*

Up to the present, the national courts of the member countries have had joint jurisdiction with the Commission both in the enforcement of Article 85(1) and Article 86 and in granting exemptions under Article 85(3).[8] The Regulation changes this status.

a. The Regulation (Art. 9) confers exclusive jurisdiction over exemptions under Article 85(3) upon the Commission.

b. The Commission is also solely competent to apply Articles 85(1) and 86 in cases where it has started proceedings (Art. 9(3)).

By concentrating jurisdiction in this manner conflicts and inconsistencies in rulings on exemptions for "good cartels" are to be minimized.[14]

The Regulation would appear to oust the national courts in all cases where parties have applied for a negative ruling or for an exemption under Article 85(3). If the Commission itself initiates a proceeding it would have the same effect.

Some question remains as to the status of private litigation for damages or to enforce agreements under national laws.[15]

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[14] Article 88 of the Rome Treaty.

[15] Under Article 177 of the Rome Treaty a question of interpretation of the Treaty raised in a court of one of the member states may, if the court wishes, be submitted to the European Court for a decision. This was done in the first case to involve an antitrust point which was recently heard by the European Court. A decision has not yet been handed down.

9. *Jurisdiction Over Foreign Trade, Foreign Agreements and Foreign Parties*

The Regulation is silent on the question of what jurisdictional claims are made by the Commission over foreign trade, foreign agreements or foreign parties. This is, of course, a very controversial topic[15a] and will no doubt be treated in Rules of Procedure to be adopted later.

Foreign Trade

Article 85 is directed at agreements which are likely to unfavorably affect trade *between* member states and which restrain competition *within the Common Market.* These two geographic references are generally construed as exempting cartel agreements relating solely to export trade outside the Common Market.[16] This is a different approach from that of the U. S. antitrust laws which prohibit restraints both in the export and in the import trade of the U. S.[17]

Foreign Agreements Affecting Internal Trade

By defining the prohibited agreements and practices in terms of their effects within the Common Market, the Rome Treaty inferentially includes agreements regardless of where they were executed or the nationality of their parties. Mr. Verloren van Themaat, speaking at the 1960 Institute on Legal Aspects of the European Community, said:

> "Foreign enterprises will also come within the province of Articles 85 and 86 when they fulfil the conditions of application of these Articles. The mere fact that they are established in a third country does not exempt them from the application of the said Articles to their activities in the Common Market" (p. 115).

15a See Hug, *The Applicability of the Provisions of the European Community Treaties against Restraints of Competition to Restraints of Competition Caused in Non-Member States, But Affecting the Common Market,* Frankfurt Institute (1960).

16 Report of the Committee on Foreign Law, 14 *Record, A.B. City of New York,* 382 (1959).

17 Brewster, *Antitrust and American Business Abroad* (1958), 18 *et seq.*

Other antitrust laws adopt the same view. The German law is quite explicit in this respect. Article 87(II) provides:

> "This statute is to be applied to all restraints on competition which are effective within the territories for which the statute is being enacted, even if they have been instigated outside of the territory for which this statute has been enacted."

There is no regulation of the Commission exempting agreements because they have been entered into abroad, or because they state they are to be governed by foreign law, or because some or all of the parties are enterprises belonging to non-Common Market countries.

A separate question arises in respect of jurisdiction over persons.[18] In the original draft of the Regulation by the Commission, notification of certain agreements was compulsory between *enterprises of more than one member state.* This excluded agreements between enterprises of a foreign state and an enterprise of one of the member states. The new Regulation significantly drops this definition.

The legal experts advising the Commission are now studying the jurisdictional questions of implementing the Regulations in respect of foreign enterprises.

10. *Procedural Safeguards*

It is of the utmost importance to enterprise that the Right of Defense, or what in our jurisprudence is called a fair hearing procedure, is recognized in all proceedings brought by the Commission and its organs. The safeguarding of such right has been recognized in principle. It is recognized by inference in the Treaty rules of appeal. It has been recognized in the commentaries of the Commission to earlier proposals.[19]

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18 See Hug, cited above.

19 Statement of Reasons, to First Draft Regulation under Rome Treaty Antitrust Clauses, Art. 15. Cf. Nebolsine, "The 'Right of Defense' in the Control of Restrictive Practices Under the European Community Treaties," 8 A. J. Com. Law, 433 (1959).

From the very beginning of its work, the International Chamber of Commerce (ICC) Commission on Restrictive Business Practices has pressed upon the Brussels Commission the adoption of the recognized basic elements of the Right of Defense.[30]

The issuance of Rules of Procedure will soon reveal to what extent the Commission is prepared to offer tangible guaranties of these procedural safeguards.

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APPENDICES

A. ARTICLES 85 AND 86 of the EUROPEAN ECONOMIC COMMUNITY TREATY.

B. REGULATION NO. 17. First Regulation for the Application of Articles 85 and 86 of the Treaty

A.

ARTICLES 85 and 86 of the EUROPEAN ECONOMIC COMMUNITY TREATY.*

Chapter 1

RULES GOVERNING COMPETITION

Section 1

RULES APPLYING TO ENTERPRISES

Article 85

1. The following shall be deemed to be incompatible with the Common Market and shall hereby be prohibited, namely: any agreement between enterprises, any decisions by associations of enterprises and any concerted practices which are likely to (unfavorably) affect trade between the Member States and which have as their object or result the prevention, restriction or distortion of competition within the Common Market, in particular those consisting in

(a) the direct or indirect fixing of purchase or selling prices or of any other trading conditions;

(b) the limitation or control of production, markets, technical development or investment;

(c) market-sharing or the sharing of sources of supply;

(d) the application to parties to transactions of unequal terms in respect of equivalent supplies, thereby placing them at a competitive disadvantage; or

(e) the subjecting of the conclusion of a contract to the acceptance by a party of additional supplies which, either by their nature or according to commercial usage, have no connection with the subject of such contract.

2. Any agreements or decisions prohibited pursuant to this Article shall be null and void.

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* Unofficial translation.

3. Nevertheless, the provisions of paragraph 1 may be declared inapplicable in the case of:

any agreements or classes of agreements between enterprises,

—any decisions or classes of decisions by associations of enterprises, and

—any concerted practices or classes of concerted practices which contribute to the improvement of the production or distribution of goods or to the promotion of technical or economic progress while reserving to users an equitable share in the profit.

(a) neither impose on the enterprises concerned any restrictions not indispensable to the attainment of the above objectives;

(b) nor enable such enterprises to eliminate competition in respect of a substantial proportion of the goods concerned.

Article 86

To the extent to which trade between any Member States may be (unfavorably) affected thereby, action by one or more enterprises to take improper advantage of a dominant position within the Common Market or within a substantial part of it shall be deemed to be incompatible with the Common Market and shall hereby be prohibited.

Such improper practices may, in particular, consist in:

(a) the direct or indirect imposition of any inequitable purchase or selling prices or of any other inequitable trading conditions;

(b) the limitation of production, markets or technical development to the prejudice of consumers;

(c) the application to parties to transactions of unequal terms in respect of equivalent supplies, thereby placing them at a competitive disadvantage; or

(d) the subjecting of the conclusion of a contract to the acceptance, by a party, of additional supplies which, either by their nature or according to commercial usage, have no connection with the subject of such contract.

B.

REGULATIONS NO. 17.*

First Regulation for the Application of Articles 85 and 86 of the Treaty

THE COUNCIL OF THE EUROPEAN ECONOMIC COMMUNITY,

owing to the provisions of the Treaty establishing the European Economic Community, namely its Article 87;

owing to the proposal of the Commission;

owing to the advice of the Economic and Social Committee;

owing to the advice of the European Parliamentary Assembly;

considering that in order to set up a system which will ensure that competition will not be perverted in the Common Market, a well-balanced application of Articles 85 and 86 should be provided in an even manner in the member States;

considering that the conditions of application of Article 85, paragraph 3 must be determined while keeping in mind, on the one hand, the necessity to ensure an efficient control and, on the other hand, the necessity to simplify the administrative control to the greatest possible extent;

considering that, consequently, it appear necessary in principle to subject the enterprises which desire to avail themselves of the provisions of Article 85, paragraph 3 to the obligation to notify their agreements, decisions and concerted practices to the Commission;

however, considering on the one hand that said agreements, decisions and concerted practices are likely in great number

* Unofficial private translation.

and, therefore, may not be simultaneously examined and, on the other hand, that some of them assume particular characteristics which may render them less dangerous to the growth of the Common Market;

considering, therefore, that with respect to certain categories of agreements, decisions and concerted practices a more flexible system should be provided, without judging beforehand their validity in regard to Article 85;

considering, on the other hand, that the enterprises may have an interest in knowing whether some agreements, decisions or practices in which they are participating or contemplate to participate in are susceptible to lead to the intervention of the Commission pursuant to Article 85, paragraph 1 or Article 86;

considering that in view of the uniform application of the provisions of Articles 85 and 86 in the Common Market it is necessary to fix the rules according to which the Commission, acting in close and constant contact with the competent authorities of the member States, may take the measures which are necessary for the application of Articles 85 and 86;

considering that to such effect the Commission must obtain the assistance of the competent authorities of the member States and, furthermore, have the power within the entire Common Market to require the information and make the verifications which are necessary in order to disclose the agreements, decisions and concerted practices prohibited by Article 85, paragraph 1 as well as the abusive exploitation of a dominating position prohibited by Article 86;

considering that in order to fulfil its mission to look after the application of the provisions of the Treaty the Commission must be empowered to address to the enterprises or associations of enterprises recommendations and decisions intended to put an end to the violations of Articles 85 and 86;

considering that the respect of the provisions of Articles 85 and 86 and the fulfilment of the obligations imposed upon the enterprises and associations of enterprises in application

of the present Regulations should be ensured by means of fines and daily fines;

considering that it is fitting to establish the right of the interested enterprises to be heard by the Commission, to give to third parties whose interests may be concerned by a decision, an opportunity to present first their observations as well as to assure the decision of a wide publicity;

considering that all the decisions rendered by the Commission in application of the present regulations are subject to the control of the Court of Justice according to the conditions as defined by the Treaty and that, furthermore, the Court of Justice in application of Article 172 has full jurisdiction regarding the decisions whereby the Commission imposes fines and daily fines;

considering that the stipulations of the present regulations may become effective without prejudice to other provisions which may be stipulated later on pursuant to Article 87;

HAS RESOLVED THE PRESENT REGULATIONS:

Article 1—Principle

The agreements, decisions and concerted practices referred to in Article 85, paragraph 1 of the Treaty and the abusive exploitation of a dominating position on the market, in the sense of Article 86 of the Treaty, are prohibited and no previous decision to that effect is necessary with the reservation of the provisions of Articles 6, 7 and 23 of the present Regulations.

Article 2—Negative Rulings

The Commission may state at the request of the interested enterprises and associations of enterprises that there is no ground for the Commission on the basis of the elements brought to its knowledge, to intervene in connection with an agreement, a decision or a practice, pursuant to the provisions of Article 85, paragraph 1 or Article 86 of the Treaty.

Article 3—Discontinuance of Violations

1. If the Commission finds either on its own motion or pursuant to a request therefor, the existence of a violation of the provisions of Article 85 or 86 of the Treaty, it may by means of a decision oblige the interested enterprises and associations of enterprises to put an end to the violation which has been revealed.

2. The following are entitled to present a request to that effect:

   (a) the member States;

   (b) the individuals or corporate entities which furnish evidence of a legitimate interest.

3. Without prejudice to the other provisions of the present Regulations, the Commission may address to the interested enterprises and associations of enterprises recommendations tending to bring about the discontinuance of the violation before taking the decision mentioned in paragraph 1 above.

Article 4—Notification of New Agreements, Decisions and Practices

1. The agreements, decisons and concerted practices referred to in Article 85, paragraph 1 of the Treaty, which came after the present Regulation became effective and in favor of which the interested parties want to avail themselves of the provisions of Article 85, paragraph 3 of the Treaty, must be notified to the Commission. So long as they have not been notified, no decision for the application of Article 85, paragraph 3 of the Treaty may be rendered.

2. Paragraph 1 is not applicable to the agreements, decisions and concerted practices when:

   1) the sole participants are enterprises belonging to only one member State and when said agreements, decisions

or practices concern neither the importation nor the exportation between the member States,

2) only two enterprises participate therein and when the sole effect of these agreements is:
   (a) to restrict the freedom of a party to the contract to determine the prices or terms of transaction in the resale of merchandise which said party acquired from the other party to the contract, or
   (b) To impose upon the purchaser or the user of rights of industrial property—namely, patents, utility models, designs, or trademarks—or upon the beneficiary of contracts involving the assignment or licensing of manufacturing processes or know-how relative to the use and application of industrial techniques, limitations in the exercise of these rights.
3) Their object is solely:
   (a) the formulation or the uniform application of standards,
   (b) the common research of technical improvements if the results are accessible to all the participants, and provided each one of them may exploit them.

These agreements, decisions and practices may be notified to the Commission.

Article 5—Notification of Existing Agreements, Decisions and Practices

1. The agreements, decisions and concerted practices mentioned in Article 85, paragraph 1 of the Treaty, which exist at the date on which the present Regulations become effective and in favor of which the interested parties desire to avail themselves of the provisions of Article 85, paragraph 3 of the Treaty must be notified to the Commission before August 1, 1962.

2. The paragraph 1 is not applicable if said agreements, decisions and concerted practices belong to the categories referred to in Article 4, paragraph 2; they may be notified to the Commission.

Article 6—Decisions Concerning the Application of Article 85, paragraph 3

1. When the Commission renders a decision on the application of Article 85, paragraph 3 of the Treaty, it indicates the date from which its decision becomes effective. Said date may not be prior to the day of the notification.

2. The second sentence of paragraph 1 is not applicable to the agreements, decisions and concerted practices referred to in Article 4, paragraphs 2 and 5, paragraph 2 or to those referred to in Article 5, paragraph 1, which have been notified within the time stipulated by that provision.

Article 7—Special Provisions for Existing Agreements, Decisions and Practices

1. If any agreements, decisions and concerted practices, existing at the date on which the present Regulations become effective, notified before August 1, 1962, do not comply with the conditions of application of Article 85, paragraph 3 of the Treaty, and if the interested enterprises and associations of enterprises terminate or modify them in such a way that they no longer are subject to the prohibition stipulated by Article 85, paragraph 1, or they comply with the conditions of application of Article 85, paragraph 3, the prohibition stipulated by Article 85, paragraph 1 applies only for the period fixed by the Commission. A decision of the Commission in application of the preceding sentence may not be applied to enterprises and associations of enterprises which have not given their express agreement to the notification.

2. Paragraph 1 is applicable to the agreements, decisions and concerted practices which exist at the date on which the

present Regulations become effective and belong to the categories referred to in Article 4, paragraph 2 if they have been notified before January 1, 1964.

Article 8—Duration of Validity and Revocation of Decisions on the Application of Article 85, paragraph 3

1. The decision on the application of Article 85, paragraph 3 of the Treaty is granted for a determined time and may be accompanied by conditions and obligations.

2. The decision may be renewed upon request therefor if the conditions provided in Article 85, paragraph 3 of the Treaty continue to be complied with.

3. The Commission may revoke or modify its decision or prohibit certain determined acts to the interested parties:

   (a) if the factual situation is modified as regards an essential element of the decision;

   (b) if the interested parties commit a violation in regard to a charge imposed by the decision;

   (c) if the decision is based on incorrect indications or was fraudulently obtained, or

   (d) if the interested parties make an excessive use of the exemption of Article 85, paragraph 1 of the Treaty, which has been granted by the decision.

In the cases referred to under (b), (c) and (d) the decision may also be revoked with retroactive effect.

Article 9—Competency

1. With the exception of the appellate authority of the Court of Justice over the decisions, the Commission is exclusively competent to declare the provisions of Article 85, paragraph 1 inapplicable, in accordance with Article 85, paragraph 3 of the Treaty.

2. The Commission is competent to apply the provisions of Article 85, paragraph 1 and of Article 86 of the Treaty, even if the time stipulated under Articles 5, paragraph 1 and 7, paragraph 2 to make the notification has not expired.

3. As long as the Commission has not started any proceeding in application of Articles 2, 3 or 6, the authorities of the member States remain competent to apply the provisions of Article 85, paragraph 1 and of Article 86 in accordance with Article 88 of the Treaty, even if the time stipulated in Articles 5, paragraph 1 and 7, paragraph 2 to make the notification has not expired.

Article 10—Relations with the Authorities of the Member States

1. The Commission transmits without delay to the competent authorities of the member States copies of the requests and notifications as well as the most important documents addressed to the Commission to establish the violations of the provisions of Article 85 or Article 86 of the Treaty, or to issue a negative ruling or render a decision on the application of Article 85, paragraph 3 of the Treaty.

2. The Commission conducts the proceedings referred to in paragraph 1 in close and constant cooperation with the competent authorities of the member States which are empowered to formulate any observations regarding said proceedings.

3. An Advisory Committee on matters of cartels and dominating position is to be consulted prior to any decision following a procedure indicated in paragraph 1, and any decision concerning the renewal, modification or revocation of a decision rendered in application of Article 85, paragraph 3 of the Treaty.

4. The Advisory Committee is composed of officials who are competent in matters of cartels and dominating positions. Each member State designates one official who represents

said State and may be replaced—should he be prevented from performing his duties—by another official.

5. The consultation takes place during a joint meeting called by the Commission, not sooner than fourteen days after sending the notice of the meeting. Said notice shall be accompanied by a statement of the case and indication of the most important documents and a draft of the proposed decision for each case to be examined.

6. The Advisory Committee may submit an opinion, even if some members are absent and not represented. The results of the consultation form the subject of a written report which shall be attached to the proposed decision. It is not made public.

Article 11—Requests for Information

1. In the course of the performance of the tasks assigned to the Commission by Article 89 and by the stipulations in application of Article 87 of the Treaty, the Commission is entitled to gather all necessary information from the Governments and the competent authorities of the member States as well as from the enterprises and associations of enterprises.

2. When the Commission addresses a request for information to an enterprise or an association of enterprises, simultaneously it addresses copies of said requests to the competent authorities of the member States in whose territory the principal office of the enterprise or of the association of enterprises is located.

3. The Commission indicates in its request the legal grounds and the purpose of such request as well as the sanctions provided under Article 15, paragraph 1(b) of the present Regulations in the event that an incorrect information would be furnished.

4. Those under obligation to furnish the requested information are the owners of enterprises or their representatives

and, in cases of corporate entities, companies or associations which do not possess a legal status, the persons representing them by law or by their by-laws.

5. If an enterprise or an association of enterprises does not furnish the information required within the time stipulated by the Commission or furnishes it incompletely, the Commission may demand said information by a decision. Such decision specifies the information required, fixes the time within which the information must be furnished and indicates the sanctions provided under Articles 15, paragraph 1(b) and 16, paragraph 1(c), as well as the possibility of appeal from the decision to the Court of Justice.

6. The Commission simultaneously addresses copy of its decision to the competent authority of the member State in whose territory the principal office of the enterprise or of the association of enterprises is located.

Article 12—Investigations by Economic Sectors

1. If, in an economic sector, the development of trade between the member States, the fluctuations of prices, the rigidity of prices or any other circumstances create a presumption that in the economic sector under consideration competition is restricted or distorted within the Common Market, the Commission may decide to make a general investigation and, within the scope thereof, to ask the enterprises of said economic sector for the information necessary for the application of the principles contained in Articles 85 and 86 of the Treaty and for the fulfilment of the tasks assigned to the Commission.

2. The Commission may, in particular, request all the enterprises and groups of enterprises of the sector under consideration to communicate to it all the agreements, decisions and concerted practices exempted from notification pursuant to Articles 4, paragraph 2 and 5, paragraph 2.

3. When the Commission makes the investigation provided in paragraph 2 above, it may also request from the enter-

prises and groups of enterprises whose size creates a presumption that they occupy a dominating position on the Common Market or in a substantial portion of said market, a declaration of particular elements relating to the structure of the enterprises and to their operations, necessary in order to estimate their situation in regard to the provisions of Article 86 of the Treaty.

4. The provisions of Article 10, paragraphs 3 to 6 and of Articles 11, 13 and 14 are applicable from analogy.

Article 13—Verifications by the Authorities of the Member States

1. Upon request of the Commission, the competent authorities of the member States proceed to the verification which the Commission esteems appropriate in accordance with Article 14, paragraph 1, or which it has ordered by decision rendered in application of Article 14, paragraph 3. The agents of the competent authorities of the member States who are directed to proceed with the verifications exercise their powers by presenting written authority delivered by the competent authority of the member State on whose territory the verification is to be made. Said power shall indicate the subject and the purpose of the verification.

2. The agents of the Commission may at the request of the Commission or that of the competent authority of the member State on whose territory the verification is to be made, lend their assistance to the agents of that authority in the performance of their task.

Article 14—Powers of the Commission in Matters of Verification

1. The Commission, when performing the tasks assigned to it by Article 89 and the provisions made in application of Article 87 of the Treaty, may proceed to all the necessary

verifications concerning the enterprises and associations of enterprises.

To such effect, the agents empowered by the Commission receive the powers:

(a) for verifying the books and other professional documents;

(b) for obtaining copy of or extracts from books and professional documents;

(c) for asking for verbal explanation on the spot;

(d) for obtaining access to any premises, grounds and means of transportation of the enterprises.

2. The agents empowered by the Commission for these verifications exercise their powers by presenting a written power which indicates the subject and the purpose of the verification as well as the sanctions provided under Article 15, paragraph 1(c) of the present Regulations in the event that the required books or other professional documents would be incompletely submitted. In due time before the verification the Commission informs the competent authority of the member State on whose territory the verification is to be made of the mission and identity of the agents empowered to perform the verification.

3. The enterprises and associations of enterprises are obliged to comply with the verification ordered by decision of the Commission. The decision indicates the subject and the purpose of the verification, with the date of its beginning and indicates the sanctions provided in Articles 15, paragraph 1(c) and 16, paragraph 1(d) as well as the possibility of appealing from the decision to the Court of Justice.

4. The Commission renders the decisions mentioned in paragraph 3 above after hearing the competent authority of the member State on whose territory the verification is to be made.

5. The agents of the competent authority of the member State on whose territory the verification is to be made may, at the request of said authority or at the request of the Commission, lend their assistance to the agents of the Commission in the performance of their tasks.

6. If an enterprise opposes a verification ordered pursuant to the present article, the interested member State shall lend to the agents empowered by the Commission the assistance necessary to enable them to fulfil their mission of verification. To that end, member States shall take the necessary measures before October 1, 1962, after consulting the Commission.

Article 15—Fines

1. The Commission may, by means of decisions, impose upon the enterprises and associations of enterprises fines from one hundred to five thousand units of account when, deliberately or through negligence:

   (a) they give incorrect or distorted indications in submitting an application pursuant to Article 2 or a notification pursuant to Articles 4 and 5;

   (b) they furnish incorrect information in answer to an inquiry made in pursuance of Article 11, paragraph 3 or 5, or of Article 12, or when they do not furnish the information within the time fixed by a decision rendered in pursuance of Article 11, paragraph 5;

   (c) they submit, in an incomplete manner, when verifications are effected pursuant to Article 13 or Article 14, the required books or other professional documents, or when they do not comply with the verifications which have been ordered by decisions rendered in application of Article 14, paragraph 3.

2. The Commission may, by means of a decision, impose upon the enterprises or associations of enterprises fines amounting from one thousand to one million units of account,

which may be brought to ten percent of the business turnover realized during the preceding fiscal year by each enterprise having participated in the violation, when said enterprises and associations of enterprises, deliberately or through negligence:

(a) commit a violation of the provisions of Article 85, paragraph 1 or of Article 86 of the Treaty, or

(b) act contrary to the stipulation of charge imposed in pursuance of Article 8, paragraph 1.

In order to determine the amount of the fine, besides the seriousness of the infraction committed, its duration will be taken into consideration.

3. The provisions of Article 10, paragraphs 3 to 6 are applicable.

4. The decisions rendered pursuant to paragraphs 1 and 2 are not of a penal character.

5. The fines stipulated in paragraph 2(a) may not be imposed for acts:

(a) committed after the notification to the Commission and prior to the decision whereby it grants or denies the application of Article 85, paragraph 3 of the Treaty, to the extent that they are within the limits of the activities described in the notification;

(b) committed prior to the notification of the agreements, decisions and concerted practices existing at the date on which the present regulation becomes effective, provided such notification was made within the time indicated in Article 5, paragraphs 1 and 7, paragraph 2.

6. The provisions of paragraph 5 are not applicable as soon as the Commission has informed the interested enterprises that after a preliminary examination it esteems that the conditions of Article 85, paragraph 1 are fulfilled and that

the application of Article 85, paragraph 3 of the Treaty is not justified.

Article 16—Daily Fines

1. The Commission may through a decision impose upon the enterprises and associations of enterprises daily fines on the basis of fifty to one thousand units of account per day of delay, starting from the date fixed by the decision, in order to compel them:

   (a) to put an end to a violation of the provisions of Article 85 or Article 86 of the Treaty, in accordance with a decision rendered in application of Article 3 of the present Regulation;

   (b) to put an end to any act prohibited under Article 8, paragraph 3;

   (c) to furnish, in a complete and correct manner, an information requested by a decision rendered in application of Article 11, paragraph 5;

   (d) to comply with a verification ordered by a decision rendered in application of Article 14, paragraph 3.

2. When the enterprises or associations of enterprises have complied with the requirements in respect of which the daily fines had been imposed, the Commission may fix the final amount at a lesser figure than that which would result from the initial decision.

3. The provisions of Article 10, paragraphs 3 to 6 are applicable.

Article 17—Control of the Court of Justice

The Court of Justice has full jurisdiction under Article 172 of the Treaty to rule on the appeals made from the decisions whereby the Commission fixed a fine or a daily fine; it may suppress, reduce or increase the fine or the daily fine which has been imposed.

Article 18—Unit of Account

In view of the application of Articles 15 to 17, the unit of account shall be the one which has been retained in the establishment of the budget of the Community pursuant to Articles 207 and 209 of the Treaty.

Article 19—Hearing of the Interested Parties and Third Parties

1. Before rendering a decision as provided in Articles 2, 3, 6, 7, 8, 15 and 16, the Commission shall give the interested enterprises and associations of enterprises an opportunity to make their views known with respect to the grievances alleged by the Commission.

2. To the extent that the Commission or the competent authorities of the member States will deem it necessary, they may hear also other individuals or corporate entities. If individuals or corporate entities evidencing a valid interest ask to be heard, their request must be accepted.

3. When the Commission intends to deliver a negative attestation pursuant to Article 2 or to render a decision on the application of Article 85, paragraph 3 of the Treaty, it publishes the essential part of the content of the request or notification in question and invites any interested third parties to make their observations known within the time that it fixes, which may not be less than one month. The publication must take into consideration the legitimate interest of the enterprise in not having their business secrets divulged.

Article 20—Professional Secrecy

1. Information gathered in application of Articles 11, 12, 13 and 14 may be used only in relation to the purpose for which it has been requested.

2. Without prejudice to the provisions of Articles 19 and 21, the Commission and the competent authorities of the mem-

ber States as well as their officials and agents are bound not to divulge the information which they obtained in application of the present Regulations, which, by its nature, is covered by professional secrecy.

3. The provisions of paragraphs 1 and 2 above are not opposed to the publication of general information or data on studies which do not contain any individual indications on the enterprises or associations of enterprises.

Article 21—Publication of Decisions

1. The Commission publishes the decisions which it renders in application of Articles 2, 3, 6, 7 and 8.

2. The publication mentions the interested parties and the essential part of the decision; it must take into consideration the legitimate desire of the enterprises not to have their business secrets divulged.

Article 22—Special Provisions

1. The Commission shall submit to the Council proposals tending to subject certain categories of agreements, decisions and concerted practices referred to under Articles 4, paragraph 2 and 5, paragraph 2, to the notification provided under Articles 4 and 5.

2. Within one year from the effective date of the present Regulations the Council, upon the Commission's proposal, shall examine the special provisions which could be made notwithstanding the stipulation of these regulations with respect to the agreements, decisions and concerted practices referred to in Articles 4, paragraph 2 and 5, paragraph 2.

Article 23—Temporary System Applicable to the Decisions of the Authorities of the Member States

1. The agreements, decisions and concerted practices mentioned in Article 85, paragraph 1 of the Treaty in ref-

erence to which—before the present Regulations became effective—the competent authority of a member State has declared the provisions of Article 85, paragraph 1 inapplicable by virtue of Article 85, paragraph 3, are not subject to the notification stipulated under Article 5. The decision of the competent authority of the member State has the strength of a decision in the sense of Article 6; its validity expires, at the latest, on the date it has fixed and may not exceed three years from the effective date of the present Regulations. The provisions of Article 8, paragraph 3 are applicable.

2. The Commission rules in application of Article 8, paragraph 2 on the requests for renewals of decisions referred to in paragraph 1 above.

Article 24—Conditions of Application

The Commission is authorized to enact provisions concerning the form, the contents and other elements of the request submitted under Articles 2 and 3 and the notification stipulated in Articles 4 and 5, as well as the hearings provided in Article 19, paragraphs 1 and 2.

All parts of the present Regulations are compulsory and directly applicable in any member State.

Done at Brussels, 6th February, 1962.

For the Council:
The President:
M. Couve de Murville

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SMALL AND BIG BUSINESS: ORIENTATION OF ANTITRUST POINTS AND COUNTERPOINTS

by

S. Chesterfield Oppenheim*

On their face the major federal antitrust laws—the Sherman, Federal Trade Commission, and Clayton Acts—make no reference to business size *per se.*[1] It is clear, however, that the legislative history of these statutes imparts to the general standards of the Sherman Act and Section 5 of the Federal Trade Commission Act, as well as to the particularized provisions of the Clayton Act, the intent of an antitrust goal of protecting small business from monopolization and abuses of economic power of large enterprises.

In perspective, these laws and their judicial interpretations do not disclose a harmonious and fully rationalized body of antitrust legislation directed toward making a preference for small business the paramount yardstick. On the contrary, both these cardinal statutes and adjudication in litigated and consent antitrust proceedings attest to ambivalence in congressional, judicial, and administrative approaches to balancing the interests of small and large enterprises in the context of the private competitive system.

The ambivalence of Congress and the courts is matched by cross purposes manifested in emotional reactions of the

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1 Definition and criteria for distinguishing small, medium-size, and large business enterprises are matters on which there is no consensus. Judgments also differ regarding the economic and social values attributable to any of the above size categories. Empirical studies exist but reactions to their reliability differ and other empirical data are needed. Of the large literature on the subject, see Kaplan, *Small Business: Its Place and Problems* (1948); "Small Business and the Antitrust Laws," 16 *A. B. A. Antitrust Section Report* (1960).

public.[2] This stems from nostalgic desires to resurrect the Jeffersonian concept of political democracy in the context of economic and social equalitarian principles, while at the same time seeking to preserve the fruits of technological advances and the ensuing mass production and mass distribution which account for the rise and growth of large-scale business enterprises. Most Americans are pragmatists when they view with pride the beneficial fruits of big business. But they seem at times equally ready to impale themselves on the horns of a dilemma when their anxiety that big enterprises will gobble up independent small businessmen impels them to demand legal curbs on business size to restore the original American conception of small competitive enterprises. This is usually described as a rivalry in economic opportunity and freedom for independent business units of moderate size and for the individuals who venture small capital investments therein.

There is no intention to minimize this mixture of hopes and fears about the big and little in the American private competitive system. The cold reality is that Congress has been partly responsive to these public attitudes and has embodied in the legislative history of the Sherman and Federal Trade Commission Acts the intention to slacken what is usually labeled concentration of economic power. Nevertheless, the inherent generality of the statutory standards of the Sherman Act and Section 5 of the Federal Trade Commission Act, and even the particularized transactions and competitive effects clauses of the Clayton Act, furnish few clues to criteria of either big or small business size. To the courts has been left the task of filling, by judicial interpretations, the scope and application of both the broad and the more specific words of these statutes.

Little wonder, then, that both the corpus of these statutes and their judicial constructions call for solutions to "legal

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[2] See University of Michigan Survey Research Center, *Big Business as the People See It* (1951).

puzzles," as Justice Frankfurter characterized the process.[3] The same Justice has stressed that this process of statutory construction is not merely "an exercise in logic or dialectic."[4] The Sherman, Federal Trade Commission, and Clayton Acts are all related to the common goal of maintaining effective competition in markets in which there is opportunity for access and freedom of contesting for shares of business. These statutes should therefore be construed *in pari materia* by probing beneath the statutory words to capture the congressional intention of the three of them as interlaced expressions of national antitrust policy.[5] Ambiguity or conflict between either general or specific statutory provisions may permit resolution of congressional intention in narrow inquiry to determine violation, as exemplified in the per se illegality or unreasonableness doctrine, or in more extensive examination under a Rule of Reason approach which evaluates all relevant market facts and factors.

This process of adjudication, however, has not crystallized a congressional purpose of unifying federal antitrust policy by enshrining small business size as the *summum bonum* of private competitive enterprise. If the courts had exercised the breadth of discretion vested in them to arrive at such an oversimplified uniform principle, the result would have been glaring judicial legislation. For it seems to me clear that the congressional mood reflected in these three chief antitrust statutes has not been an unwavering allegiance to the virtues of small enterprise as inherently in opposition to the evils of big enterprise.

To be sure, Congress has enacted legislation specially designed to give affirmative aid to small business.[6] Simi-

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[3] In his dissenting opinion in *FTC* v. *Motion Picture Advertising Service Co.*, 344 U. S. 392, 406 (1953).

[4] Frankfurter, "Some Reflections on the Reading of Statutes," 47 *Colum. L. Rev.* 529, 544 (1947).

[5] See this writer's "Guides to Harmonizing Section 5 of the FTC Act With the Sherman and Clayton Acts," 59 *Mich. L. Rev.* 821 (1961).

[6] Small Business Act of 1958, 72 Stat. 384, 15 U. S. C. §§631-47 (1958); Small Business Investment Act of 1958, 72 Stat. 689, 15 U. S. C. §§661-96 (1958), amending

larly, the Senate and House Select Committees on Small Business register their sensitivity to the American mores attuned to the grass roots demand for safeguarding small business from oppression of concentrated economic power. So far as the major antitrust enactments are concerned, however, only wishful thinkers would blind themselves to the presence of apparent or actual contradictions and conflicts both in statutory words and their legislative history and in the judicial precedents flowing from the interpretative process.

There are judicial opinions in which preference for the small business ideal has been articulated either as an assumed or demonstrable congressional intention. In 1945, Judge Learned Hand, in his opinion in the *Alcoa* case, in referring to the Sherman Act and two World War II statutes, asserted that "throughout the history of these statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other." [7]

In similar vein, Justice Douglas has injected into a few of his opinions the admonitions of Brandeis, particularly in Justice Brandeis' writings prior to his appointment to the Supreme Court,[8] that evils of bigness in business enterprises stem from inefficiency and diseconomies of excessive size, even when there is no monopoly power over the market. In his dissenting opinion in *Columbia Steel,* Justice Douglas observed that the lesson of the problem of bigness "should by now have been burned into our memory by Brandeis. The Curse of Bigness shows how size can become a menace—both industrial and social." [9] "Industrial power should be decen-

§§4 and 7 of the Small Business Act of 1958, 72 Stat. 384, 387, 15 U. S. C. §§633, 636 (1958). *Cf.* Automobile Dealer Franchise Act of 1956, 70 Stat. 1125, 15 U. S. C. §§1221-25 (1956).

7 *United States* v. *Aluminum Co. of America,* 148 F. 2d 416, 429 (2d Cir. 1945).

8 Among them is a collection of papers in Brandeis, *The Curse of Bigness* (1934). See also the critique in Brandeis, "Competition and Smallness: A Dilemma Re-Examined," 66 *Yale L. J.* 69 (1956).

9 *United States* v. *Columbia Steel Co.,* 334 U. S. 495, 535 (1948).

tralized," he said, as a part of the "philosophy and command of the Sherman Act." [10]

There is no need for elaboration of the obvious teaching of the background and legislative history of the Sherman Act that Congress was deeply concerned about monopolistic aggregations of capital and power created by combinations.[11] Neither the subsequent federal antitrust legislation in the Federal Trade Commission and Clayton Acts, and their judicial interpretations, nor the infusion in those supplementary enactments of the incipient violation doctrine has furnished support for a generalization that small business cannot survive unless bigness per se is declared antipodal to the public interest. Epithets, such as the "Curse of Bigness," serve to distort rather than to bring into concord the inherent advantages of enterprises of small, medium, and large dimensions, whatever the criteria for their measurement may be.

The conclusion is that no synthesis of the antitrust statutory provisions and their judicial interpretations can be constructed on the unitary principle that only small business is in the public interest. However, it does not follow that this body of antitrust law provides no basis for orientation which, in retrospect and perspective, gives a sense of direction to composing the seeming conflict between the economic and social values of large and small enterprise. Indeed, antitrust court opinions reveal both articulate guides and adumbrations on this relationship between business size and antitrust policy.[12] What follows is an attempt to pull together these threads without pretense of portraying an end product in which all pieces fall neatly into place.

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[10] *Id.* at 536.

[11] See Thorelli, *The Federal Antitrust Policy* (1954).

[12] *E.g.*, Justice Frankfurter's dissenting opinion in *FTC* v. *Motion Picture Advertising Service Co.*, 344 U. S. 392, 398 (1953); majority opinion of Mr. Justice Reed in *United States* v. *E. I. du Pont de Nemours & Co.*, 351 U. S. 377 (1956); Justice Black's majority opinion in *Northern Pacific Ry. Co.* v. *United States*, 356 U. S. 1 (1958).

The pressures that originally brought the Sherman Act into being were undoubtedly caused by distrust of uncurbed power of the "trusts" of that era. This fear still exists even when concentrated economic power is not monopolistic and is not abused by overt predatory or unreasonable conduct aimed at foreclosing existing or potential competitors. But in the more recent past, the supplemental Federal Trade Commission and Clayton Acts brightened the traditional American image of the small and independent businessman by introducing certain checks and balances—which may also be characterized as "countervailing power"—to bolster the concept of the individual firm of modest size as a prime motive power of virile competition.

The contours of these laws and what the courts have ascribed to their congressional architect disclose that antitrust means many things in political, economic, social, and ethical values. The only unifying set of premises are those which are directed toward the yardstick of maintaining a competitive enterprise order. Translating this guidepost into the diversities and dynamics of American industries and markets inevitably underscores the generality and flexibility of the congressional charters of antitrust policy, tempered as they have become by a set of unreasonable per se proscriptions which either Congress has commanded, as in Sections 2(c), (d), and (e) of the Robinson-Patman Act, or the courts have interpolated as in the Sherman Act.

To my way of thinking, the three major federal antitrust laws have not negated the generally accepted economic concept that all individuals and parts of our modern economy are interdependent. Modern technology, communication, and transportation have fortified rather than diluted this interdependence. There is no reliable empirical evidence that competition in the United States is on the decline. Statistical data on economic concentration still continue to be controversial with respect to the validity of statistical methods and

measures and interpretations of data.[13] In this state of disputed factual data or lack thereof, it would be folly to suppose that liquidation of large business size or attempts to define unreasonable business size or unreasonable market power short of monopolization and place statutory limits thereon should be preferred to recognition that in the contemporary American economy, all sizes of business units can coexist so long as in structure, behavior, and accomplishment they measure up to the paramount goal of maintaining competition.

This brings into view the belief that the competition to be preserved under antitrust policy cannot be guided by the polar abstractions of perfect competition and absolute monopoly. In actuality the various forms of competition are today imperfect. A realistic antitrust policy must settle for conditions compatible with effective or workable competition in any given industry or market. We cannot hope for all the competition that is theoretically possible.

Bearing in mind these new kinds of competition, one can readily understand how futile it would be to yearn for an economy of small businesses such as existed prior to the matured American industrial system. So long as private competitive rivalry is the pole star, the small-business unit ideal cannot and will not be the sole medium for waging competition in the present day American economy. Numerous industries or markets in which a few large sellers account for the major percentage of production and sales—dubbed oligopolies by economists[14]—consist of firms which compete effectively. A competitive oligopoly should be free from antitrust attack in the absence of collusive practices.

As of now, the Supreme Court has not condemned large business size as violative of the Sherman Act. Mere size has also not been decisive of violation of amended Section 7 of

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13 See bibliography in my *Federal Antitrust Laws: Cases and Comments* 298-99 (2d ed. 1959).

14 For literature on the concept of workable competition and the diversity of views on oligopoly structure and behavior, see *id.* at 296-98.

the Clayton Act in adjudication of merger cases. Size which constitutes monopoly power—power to fix prices and to exclude competitors from a relevant market—as one element of the offense of monopolization under Section 2 of the Sherman Act is in a different category. From a structural standpoint, oligopoly power has not yet been equated with monopoly power under that statute.

A few writers have suggested the theory that oligopoly behavior is inherently anticompetitive. This approach tends to identify price leadership, so-called administered prices, and even conscious parallelism of business conduct—and often the resulting uniform prices in a given market at a given time—as the indicia of tacit collusion among oligopolists.

The Supreme Court, however, has ruled that "conscious parallelism has not yet read conspiracy out of the Sherman Act entirely." [15] This would otherwise broaden in dragnet fashion the implied conspiracy doctrine. In the 1946 *American Tobacco* case,[16] the Big Three in cigarettes were found guilty of conspiratorial conduct aimed at control of the leaf tobacco auction markets and the distribution and pricing of their major brand cigarettes. Collusive abuse of oligopoly power, not oligopoly power per se, was the basis for the criminal conviction in that case.

Proponents of the primacy of small business in competitive enterprise apparently discount heavily the economic conception of the interdependence of all sizes of business enterprises as the most promising assurance of a viable competitive process. The limits set by the existing antitrust laws on monopolistic power, on growth by mergers which violate the standards and tests of amended Section 7 of the Clayton Act, and on abuses of economic power by a single firm or a combination and conspiracy among competitors, in my judgment have not failed to balance with reasonable success the inter-

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15 *Theatre Enterprises, Inc.* v. *Paramount Film Distributing Corp.*, 346 U. S. 537, 541 (1954).

16 *American Tobacco Co.* v. *United States*, 328 U. S. 781 (1946).

ests of the big and the little businesses. The present Supreme Court doctrine reaffirms the flexible Rule of Reason method of inquiry into all relevant market factors and circumstances in a case by case inquiry in a proceeding based upon Section 2 of the Sherman Act pertaining to monopolization. Monopoly power of a single firm is exceptional, if not rare, and the defense of a monopoly thrust upon a company is also likely to have narrow applications. Since the 1940's, *Pullman,*[17] *Alcoa,*[18] and *United Shoe*[19] illustrate Section 2 cases, apart from earlier "trust" or holding company cases, including those involving railroads, where the Government was successful in proving illegal monopolization. The recent shift of focus to amended Section 7 merger cases may be said to be attributable to the rarity of a single enterprise monopoly in structural size and shape. There is little likelihood that, with the presence of reasonably interchangeable products in virtually all American markets, one firm can acquire or maintain a stranglehold of monopoly power.

Against this backdrop, it seems that equal justice under antitrust policy cannot be accorded through emotional attachment to small business units as the savior of antitrust policy on economic grounds, or, for all that, on political or social grounds. The cost to the economy of this approach would simply be too high. The admitted values of small enterprise can otherwise be preserved. The need for a crusade in behalf of small business is neither theoretically nor empirically supportable.

It is high time that advocates of a positive orientation of antitrust policy toward the preservation and special protection of any one class of business-size enterprise, or negatively, against big business as a predesigned antitrust target, recognize the unreality of this American folklore. Just as it would

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[17] *United States* v. *Pullman Co.,* 50 F. Supp. 123 (E. D. Pa. 1943), 64 F. Supp. 108 (E. D. Pa. 1946), aff'd, 330 U. S. 806 (1946).

[18] *United States* v. *Aluminum Co. of America,* 148 F. 2d 416 (2d Cir. 1945).

[19] *United States* v. *United Shoe Machinery Corp.,* 110 F. Supp. 295 (D. Mass. 1953), aff'd *per curiam,* 347 U. S. 521 (1954).

be rash to cultivate an attitude of inherent opposition between government and business, so it is equally self-defeating to entrench an attitude of inherent antagonism between small and large enterprises. Interdependence and mutuality of interests are the keys to reconciliation and resolution of the respective roles of businesses of all sizes, subject to the prohibitions of the antitrust laws in the context of conduct inherently unreasonable per se or through "a definite factual showing of illegality," or unreasonableness under an extended Rule of Reason inquiry, whether antitrust violation is governed by the statutory test of an incipient or consummated violation doctrine. Distrust of large business size, as well as placing a halo of purity around small business size, are each incompatible with faith in antitrust policy itself. Bigness is not per se vice nor is smallness per se virtue.

Nothing here written should be construed as intended to understate the case for the rightful claims of small business. Affirmative aid to small enterprises in the nature of countervailing power which does not have the purpose or effect of negating competitive spirit and rivalry is both desirable and commendable. Big business is also obligated to assume responsibility commensurate with its impact on the economy and with the interests of its smaller competitors and suppliers, as well as its stockholders and the ultimate consumers of its products, all of whom depend on equity and fair dealings in big business policies and decision-making.

Big business behaviorism is and should be constantly subjected to close scrutiny. Its own sense of self-restraint and corporate conscience may be more effective than positive law and antitrust prohibitions. One can be pro-bigness without being anti-smallness and the reverse is also true. Technological progress, patented and unpatented innovations from research and development, expansion of production and markets, and all of the other indicia of progressiveness vary in nature and degree with sizes of businesses but none can rightfully claim this progressiveness is imputable solely to enterprise of a given scale. If anything is apparent, it is the conflict

of views among economists regarding what is optimum business size or scale in relation to efficiency and economy and the conflict of data regarding the causal relation between business size and actual or potential contribution to the economy. In such a state of knowledge and empirical data, it makes good sense to proceed on the assumption that there are degrees of difference in contributions in the spectrum from the largest to the smallest of enterprises. Size may thus be advantageous, disadvantageous, or a neutral factor. Making small business units the wards of a guardian antitrust policy will not change the realities, no matter what definitional structure is adopted for identifying the large, the medium, and the small sizes of business firms or multi-plant enterprises.

Amended Section 7 of the Clayton Act is undoubtedly an expression of a firm congressional purpose to stop in its incipiency undue concentration of economic power by mergers through stock or assets acquisitions. The legal test is whether the acquisition creates a reasonable probability of substantial lessening of competition or tends to create a monopoly in any line of commerce in any section of the country—that is, in a relevant product and geographic market. Labeling amended Section 7 an antimerger statute is a misnomer. The statute does not condemn mere bigness resulting from a merger. The prohibited adverse competitive effects must be shown to be reasonably likely.

Amended Section 7 may be thought to be abortive of growth by acquisitions of competitors and hence a statute whose by-products in successful suits by the Justice Department and by the Federal Trade Commission, as well as by private parties, redound to the advantage of small business. This is an oversimplified version. Mergers may benefit the small as well as the big and still promote rather than substantially lessen competition. Hence, it is not sound to generalize that mergers are always a causative factor in creating excessive concentration to the detriment of small business. At any rate, there is no sign that Congress will relax its insistence upon curbing growth by the easier route of acquiring com-

petitive companies. Small business has a proper claim in demanding this degree of protection but should be equally interested in continuation of the Rule of Reason method of extensive inquiry—which Justice, the Federal Trade Commission, and the courts thus far appear to be applying—in adjudicating the legality of a merger.[20] Otherwise, amended Section 7 might boomerang to strike down mergers of small firms or to hobble their opportunity to dispose of their business, apart from the "failing company" defense.

Turning to another large area of antitrust, it is evident that small business cannot, and should not, expect immunity from antitrust proceedings when the small business units combine and conspire to engage in cartel-like practices. Antitrust must continue to be an anti-cartel policy. Perhaps some limitations may be tolerated in foreign commerce when the conditions of trade with other countries deny to American enterprise opportunities for export or import.[21] Anti-cartelism is clearly applicable to restraints of trade through concerted action of competitors to fix market prices, control production, divide territories, or allocate customers. These restraints, by their inherent nature or character, are deemed conclusively unreasonable once the fact of the conspiracy is established—the so-called illegal per se doctrine. Group commercial boycotts or refusals to deal by sellers or buyers also have been included in this category. It would be indefensible to exempt small business from this class of restraints or to permit them to establish justifications for such conduct which are not available to large business units. Even the small business unit ideal assumes individual action by each competitor exercising his independent discretion as to what and how much to produce, the persons to whom he sells, the price he demands, and the methods of distribution he employs. Certainly the Department of Justice and the Federal Trade Com-

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[20] This writer's view is set forth in 17 *A. B. A. Antitrust Section Report* 37, 69-72 (1959).

[21] See Fugate, *Foreign Commerce and the Antitrust Laws* (1959); Brewster, *Antitrust and American Business Abroad* (1958).

mission have not shown any disposition to discriminate between the large and the small so far as these unreasonable per se violations are concerned. The trumpets of the "watch-dog" Senate and House Select Committees on Small Business may blare loudly for "protectionism" for the benefit of their small business "wards," but, in reality, there is no absolution under antitrust policy for any group when cartelism rears its head.

The benign attitude of Justice Brandeis toward trade associations activities of benefit to the small concerns which would not otherwise become as well informed about market conditions should be noted.[22] But there is little basis for assuming that the leading Supreme Court opinions on trade association programs[23] augur tolerance of cooperative conduct of associations comprised of a majority of small firms, whereas those which have a membership of large firms or more large than small firms will be judged more severely. Again the prevailing judicial trend is that trade association barriers to the competitive process will be judged without according special privilege to groups of small enterprises.

Patent rights in relation to the public policy of the patent and antitrust laws is a subject too complicated for summary treatment.[24] It may be said, however, that in this area also, there is no doctrinal trend which singles out the small owner of patent rights for favored treatment. Both the large and small may accumulate patent rights without being threatened with per se illegality solely on that ground. Patent licensing by small and large brings into play the basic distinction be-

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[22] See his dissenting opinion in *American Column & Lumber Co.* v. *United States*, 257 U. S. 377, 413 (1921).

[23] *American Column & Lumber Co.* v. *United States*, 257 U. S. 377 (1921); *United States* v. *Linseed Oil Co.*, 262 U. S. 371 (1923); *Maple Flooring Mfgrs. Ass'n* v. *United States*, 268 U. S. 563 (1925); *Cement Mfgrs. Protective Ass'n* v. *United States*, 268 U. S. 588 (1926); *Sugar Institute, Inc.* v. *United States*, 297 U. S. 553 (1936); and analysis in Lamb & Kittelle (assisted by Carrington Shields), *Trade Association Law and Practice* (1956).

[24] See *Att'y Gen. Nat'l Comm. Antitrust Rep.*, Ch. V (1955); and this writer's "Patents and Antitrust: Peaceful Coexistence?" 54 *Mich. L. Rev.* 199.

tween limitations in licenses through unilateral action of the patent owner in vertical transactions and horizonal combination or conspiracy between the patent owner and his licensees or among the licensees.

There is more latitude for responsiveness to the interests of small business as a group under the Robinson-Patman Act. It would be unjustified to brand this law against illegal price and service discriminations as class legislation. It is generally admitted, however, that this 1936 statute, amending the original Section 2 of the Clayton Act, resulted from political pressures to protect the conventional marketing system and the small independent businessmen against the invasions of mass distributors—particularly the chain stores but also the department stores and mail order houses—whose ability in resources to buy and sell at low prices highlighted the legislative purposes of this law.

This is not the occasion to explore the implications and decisions of the Robinson-Patman Act, which is sometimes called a charter of "independence for the independents."[25] Suffice it to point out that this chameleon-like enactment has a duality of objectives only some of which are reconcilable with "the broader antitrust policies." The basic injury to competition provision in Section 2(a) of the Act has only partially been translated into a Rule of Reason method which seeks to ascertain "the substantiality of effects reasonably probable." Injury to particular competitors is infused into Commission adjudications, but this is still short of an automatic per se violation approach. The defense of meeting competition under Section 2(b) of the Act is undergoing a process of further crystallization in adjudications subject to present limitations that narrow this absolute defense even when there is good faith. Discriminatory practices under Sec-

[25] See *Att'y Gen. Rep.*, *supra* note 24, at 155-209; the numerous articles in legal periodicals by Frederick M. Rowe, a leading writer on the Act and the author of forthcoming book, *Price Discrimination Under the Robinson-Patman Act* (scheduled for publication early in 1962); Edwards, *The Price Discrimination Law* (1959). This writer's views are set forth in 17 *A. B. A. Antitrust Section Report* 37, 56-69 (1959).

tions 2(c), (d), and (e) of the Act—relating to brokerage commissions, promotional allowances, and services and facilities—have been declared per se violations by Supreme Court construction of congressional intent.[26]

Small business has undoubtedly benefited from this statute but not uniformly so. It is ironic that, in some Commission decisions, the Act boomeranged against small enterprises. It has clearly not been applied as a statute only for the protection of the small and against the big. Equally clear is that the Robinson-Patman Act continues to be controversial on the issue of the extent to which it is reconcilable with national antitrust policy.

Section 3 of the Clayton Act pertaining to exclusive dealing, requirements contracts, and tying clauses has also not been construed with judicial resolve to prefer small business against their large-scale competitors as the matrix of congressional intent. Yet this provision, tested by the incipiency doctrine of reasonable probability of substantially lessening competition or tending to create a monopoly in any line of commerce in certain respects has redounded to the advantage of small enterprises. Its curbs have been frequently applied to dominant companies and to enterprises which have leverage in patent rights. So far as exclusive dealing is concerned, *Tampa Electric*[27] refers to the quantitative dollar volume measure as "ordinarily of little consequence." The majority of the Supreme Court has indorsed an extended Rule of Reason market inquiry in determining whether adverse competitive effects are reasonably probable. Delimitation of the relevant product and geographic market is considerably tightened as a matter of proof. Particularized circumstances of each case must be probed. There are undoubtedly by-product benefits to small business to the extent that Section 3 bans transactions of sale or lease when requirements contracts or other forms of exclusive dealing involve foreclosure of a substantial volume

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[26] *FTC* v. *Simplicity Pattern Co.*, 360 U. S. 55 (1959).

[27] *Tampa Electric Co.* v. *Nashville Coal Co.*, 365 U. S. 320, 329 (1961).

of commerce in the relevant market. *De minimis* or insubstantial effects will be the privileged conduct of the small market units.

Tying clauses "fare harshly" under the antitrust laws and "serve hardly any purpose beyond suppression of competition," as the Supreme Court has warned. In this area, illegality for the small perhaps looms as a greater risk than in the case of exclusive arrangements, but again the statutory tests of violation make crucial the question of what is foreclosure of a substantial volume of commerce in the relevant market. On that basis, smallness is not automatically exculpated from this species of antitrust violation. Both the big and little, however, are privileged to prescribe reasonable specifications for the tied product.

The Fair Trade Acts[28] were enacted by the states under pressures from small business for statutory curbs on price cutting—especially with respect to leaders and loss leaders of nationally advertised brand name products which provide the bait for luring customers into the "bargain" stores, today known as "discount houses." Congress passed enabling amendments to the Sherman and Federal Trade Commission Acts to make lawful, even when the goods move in interstate commerce, contractual and vertical resale price maintenance when the contracts comply with the law of the state where the goods are resold, while still banning horizontal price fixing. As of today, small business has learned that many of the words of promise to it in these statutory safety measures have been broken to the hope. Some of the state Fair Trade Acts have been held unconstitutional as a whole and the "non-signer" clause, binding all dealers not to cut prices knowingly below the minimum or stipulated price of the contract parties, has been declared unconstitutional in many states. Discount and mail order houses have also found a legally sanctioned chink in the dikes erected by these state statutes. Here, like the Robinson-Patman Act, small business has discovered that spe-

[28] See *Att'y Gen. Rep., supra* note 22, at 149-55.

cial legislation for its benefit at times may be delusive, if not a trap.

This orientation discussion of the small and large size business enterprises—which as a matter of definition also poses the question what is a medium-size business enterprise—brings us back to the thesis that, however size may be defined by guiding criteria, there is no unison in existing antitrust policy on the relationships of these business sizes to the public interest apart from the generalization that the paramount goal is to support effective competition. Competition that is restricted for the supposed benefit of one group may generate unforeseen effects which harm the intended beneficiaries. There are few, if any, all black or all white areas in structure, behavior, or accomplishments of small and large business. Fair and effective antitrust enforcement cannot be achieved by singling out any category of business size for preservation simply by striking down the inherent advantages normally arising from the fair competition of another category of business size. This does not deny to small business the direct and indirect benefits of a non-discriminatory antitrust policy which keeps open reasonable opportunity of entry and growth, even though unavailability of investment capital and other barriers not artificially erected by competitors may make entry and growth impracticable.

In my opinion, there is no need for any basic substantive revision in existing antitrust policy so far as it pertains to the problem of business bigness under the present doctrinal trend in judicial decisions and interpretations of the offenses of Section 2 of the Sherman Act covering monopolization, attempts to monopolize, and combinations or conspiracies to monopolize. Amended Section 7 of the Clayton Act also provides ample sanctions in limitations on growth by acquisitions of stock or assets of other firms. It is doubtful that Congress can count upon popular support, or even general approval of authoritative economists, for antitrust revisions which place statutory limits upon the size of a firm or enterprise

or its market shares when the transactions or conduct do not meet the existing tests of violation of Section 2 of the Sherman Act. American industries are too differentiated and dynamic to make either sound or practicable administrative or legislative ceilings on business size or market shares on an over-all basis.

Continuation of the case by case adjudication under prevailing antitrust legislation, pursuant to a Rule of Reason approach which takes into account structural, behavioral, and accomplishment aspects, offers the most promising approach. While still a subject of conflicting views among economists, the concept of effective or workable competition and the economic factors pertinent to its identification in a given relevant market, "rough and ready" as some of these criteria may be, constitutes an approach far preferable to the extreme proposals aimed at restructuring through liberal use of the radical remedies of dissolution, divorcement, and divestiture, the structure and market power complexes of the big enterprises. Workable or effective competition, of course, is not an express congressional or judicial yardstick for antitrust policy or adjudication of cases, but there are signs of its judicial recognition.[29] Moreover, antitrust abuses of economic power are more readily identifiable and such curbs are being vigorously applied.

In economic power cases, the courts have not branded vertical forward or backward integration or diversification of products and functions (sometimes called conglomerate) as per se antitrust violations.[30] Only when these forms of business growth are accompanied by an illegal purpose or used as leverage for abuse of market power, such as a monopolistic price squeeze, have they been condemned as antitrust trans-

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29 *E.g.*, opinion of Judge Leahy in *United States* v. *E. I. du Pont de Nemours & Co.*, 118 F. Supp. 41, 48-50 (D. Del. 1953), and majority opinion of Justice Reed on appeal, 351 U. S. 377, 385-94 (1956).

30 See Hale & Hale, *Market Power: Size and Shape Under the Sherman Act*, Chs. 5, 6 (1958).

gressions. It is hoped that neither Congress nor the courts will depart from these sound principles. Yet there are indications in some quarters that vertical integration and diversification are viewed with alarm as sources of building up strategic advantages of giant enterprises. The question is whether these advantages are compatible with or in opposition to effective competition. Both are forms of business growth which should be sanctioned unless otherwise shown to be coupled with proven illegal purpose or effects.

In sum, this orientation of the facets of small and big enterprise against the background and evolution of antitrust policy and judicial construction supports the conclusion that realistic, fair, and effective antitrust enforcement cannot be effectuated through romanticism which pays homage to either small or large business organizations as the sole source of desired political, economic, and social values in the American order. Indeed, antitrust itself is only one among many forces which direct the course of American democracy. Dispersion of economic power of private enterprises is a cliché with considerable magnetism to those who fear business bigness, but it is equally alarming to those who see all around them undeniable evidence of the impressive achievements of American large-scale enterprise.

Competition is a mechanism for spurring rivalry of each with others of his economic group (manufacturers or distributors) for the patronage of members of other economic groups (buyers). Manufacturers, wholesalers, retailers, and others compete most often at different levels of competition or sometimes through integration or diversification of functions. This competition compels each to offer the most attractive package of values measured not only in price but also in so-called non-price competition in quality, service, design, packaging, delivery time, or any other value the customer desires. This positive concept of competition under our antitrust policy is dependent upon a market-determined process. Impersonal market pressures on the supply and demand side

constantly coordinate and direct activities. It is this spontaneous discipline of competition, subject to antitrust curbs, to which both the large and small must submit, which determines customer acceptance in the market place. Imperfect though this competition may be in our mixed economy of big and little enterprises, American private competitive enterprise continues to be our primary reliance for decision-making of the intermediate and ultimate consumers who daily cast their market votes for what is produced and what is bought. These organic and open market forces, coupled with the checks and balances of the inherent nature and advantages of the role of the small and the large, go to the heart that makes our economy tick.

Antitrust policy is an unexpendable charter of economic liberties of equal importance with civil liberties, but their coexistence as part of the American milieu of political, economic, and social values requires equitable treatment of private rights of business enterprise and persons with equal justice under the Rule of Law in every sphere of the American scene.

THE ETHICS OF RETAIL PRICE ADVERTISING*

by

DANIEL J. MURPHY**

I.

May I take this opportunity[1] to express my appreciation for your gracious invitation to appear on this Program. The lofty and inspired nine major purposes of your organization —beginning with "To foster scientific study and research in the field of marketing" and ending with—"To encourage and uphold sound, honest practice and to keep marketing work on a high ethical plane"—are certainly worthy of high commendation. May you have the greatest measure of success in their practical and effective realization.

My assigned subject is, "The Ethics of Retail Price Advertising." The term "ethics" itself is a term meaning many things to many people. Without getting into a broad philosophical discussion on the definition of terms, I assume we are concerned here with the retail advertising pricing practices from the standpoint of *rightness* and *wrongness.*

It is sometimes said that business cares nothing about right and wrong; that all it is interested in is making a profit; that whatever is good business is good ethics. Therefore, why talk about the ethics of business? The majority of businessmen, like the majority of other people, have ethical standards. Much of the unethical in business is due not because the businessman means to do the wrong thing, but, because he believes it is "all right" *for him.* This simple truth is forgotten, what is right or wrong for one person is right or wrong for every one else under the same circumstances.

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* Address before the American Marketing Association, New York, N. Y. on December 27, 1961.

** Director, Bureau of Deceptive Practices, Federal Trade Commission.

1 Remarks are personal and not official.

Many times, also, the unethical act is due to thoughtlessness. Wrong acts are committed in good faith because the actor has never given serious thought to the matter one way or the other. He has merely conformed to the customs of the trade. A wrong is done on the supposition that it is right. If business ethics cannot make one completely objective, it can at least demonstrate what objectivity means.

II.

Before entering upon this discussion, may I engage in a little historical development in regard to advertising in general.

The principle "caveat emptor" (let the buyer beware) for many years was controlling in the market place. The principle had its origin in late English law and is found in a few English decisions prior to the Revolutionary War. A significant and primary decision involved a dispute between buyer and seller over a horse trade. Probably horse trading is still going on in the advertising field.

The principle "caveat emptor" became more popular in America. Its ruggedness appeared more adaptable to the then frontier economy. Advertising in the papers of the period indicated a lack of advertising ethics and a predominance of all-embracing claims for the product offered. The zenith of "caveat emptor" was reached in 1900 in *American Washboard Co.* v. *Saginaw Mfg. Co.,* 103 Fed. 281. The court stated, "If all persons are compelled to deal solely in goods which are exactly what they are represented to be, the remedy must come from the legislature, and not from the courts."

At this time, the industrial revolution was causing great changes in the market place. Advertising was growing,[2] public indigation was rising over its lack of ethics. This lack

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[2] In 1900 approximately $90 million was spent in advertising compared to approximately $12 billion in 1960.

of ethics is clearly demonstrated in the full page advertisement which appeared in newspapers, even prior to 1900, the day Grover Cleveland took office as President of the United States. There is no doubt that the advertisement was entirely without the President's consent, yet, it had the appearance of a handwritten executive proclamation. It uses the President's name, but it carefully avoids a Cleveland signature. Cleveland was known to enjoy a drink occasionally. He is represented in this advertisement as endorsing Duffy's Pure Malt Whiskey and endorsing it as a cure for practically everything.

The campaign against false and unethical advertising really began from the start of the 20th century. In 1911, *Printer's Ink* published its model state statute and launched the movement to have it enacted in every state legislature. Advertising groups across the nation joined in the campaign.

As part of the campaign to obtain ethical guides and to secure ethical advertising, the Associated Advertising Clubs, at their convention in 1911, adopted the slogan "Truth in Advertising". The Better Business Bureau joined in the fray and, in convention assembled, adopted their "Declaration of Principles" which today guides and controls the policies of all their bureaus.

As a result of this campaign, 44 states have adopted false advertising statutes. Twenty-seven states adopted the *Printer's Ink* statute without substantial change. This Act makes false advertising a criminal offense. Seventeen additional states enacted modified versions which require additional proof that the seller had knowledge that his statements were false. The addition of the words "knowingly" seriously weakened the model statute.

Inroads were being made into the doctrine of "caveat emptor" by state and federal legislation. The states have acted in many areas to obtain ethical advertising. They have acted to regulate pricing practices and 19 states have adopted

statutes prohibiting bait advertising. These two areas are of particular concern to the Federal Trade Commission as expressed in its published "Guides Against Deceptive Pricing" and "Guides Against Bait Advertising". Thus, the legal growth of state regulation has been substantial. While the buyer must still beware, the seller must also now beware.

III.

While the first states were enacting ethical advertising statutes, the movement for federal legislation to cover advertising in interstate commerce was gaining. This movement resulted in the Federal Trade Commission Act in 1914. This new statute made no mention of advertising or deception and proscribed only unfair methods of competition. This power was not specifically defined—nay, it challenged an adequate and all-inclusive definition. It was meant to be of a flexible and comprehensive character. It was also meant to be a living and vital organism, capable of growth and expansion, and of being applied to new and as yet unknown practices which may arise from time to time in the conduct and development of business. The primary thrust was the protection of businessmen, one from the other; the protection of the consumer was only incidental. The jurisdiction of the Commission was based upon injury to competition, actual or potential, and mere injury to or deception of the public did not constitute an offense under the statute.

This was evidenced by the famous 1931 Supreme Court decision[3] in the *Raladam* case. The Court held that the Commission lacked jurisdiction to proceed against false advertising where no substantial competition, present or potential, was shown to have been injured or clearly threatened with substantial injury by the advertising sought to be prohibited.

This obvious imperfection was remedied, in 1938, by the Wheeler-Lea amendment which declared "unfair or deceptive acts and practices in commerce" to be in the same unlawful

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[3] *F. T. C.* v. *Raladam Company,* 283 U. S. 643.

category as "unfair methods of competition". Since then, the Commission has been able to proceed openly and directly to protect the consumer in the market place while at the same time it continued to eradicate competitive methods which unfairly divert trade from the honest to the unscrupulous members of the business communities.

Nevertheless, from the very outset, the Commission found deceptive advertising to be an unfair method of competition where competitors were injured. The first two cases decided by the Federal Trade Commission involved false advertising.[4]

Today we have 55 volumes of Commission and court decisions—approximately more than 70% of such decisions involve false advertising or other unfair and deceptive practices, including fictitious pricing.

The first Commission case to reach the courts involved false advertising of prices.[5]

IV.

Probably the primary evil in the field of false advertising, from a volume standpoint, involves so-called fictitious pricing. Deception in advertising must be material in order to be considered misleading. Price is one of the most material elements considered by a prospective purchaser. Therefore, false information as to price is generally misleading. Fictitious pricing may be defined generally as a representation that a selling price of a product is a bona fide reduction from a former price, when, in fact, the product rarely, if ever, has been sold at the former price in the trade area where the product was offered. The use of fictitious, comparative price claims has grown to such an extent that it is today's most serious threat to public confidence in advertising, nationally and locally.

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[4] *F. T. C.* v. *Circle Silk Co.*, 1 F. T. C. 13; *F. T. C.* v. *Abbott*, 1 F. T. C. 16. Purchasers were misled to believe goods were made entirely of silk.

[5] *Sears, Roebuck & Company* v. *F. T. C.*, 258 Fed. 307 (1919).

In October 1958, the Commission initiated a new approach in issuing guides against this practice which is common to many industries. Trade practice rules and prior guides issued were peculiar to specific industries. There are 162 trade practice rules for particular industries. Forty-four of these rules have provisions relating to deceptive price representations. The guides against fictitious pricing cut across all industry boundaries. The provisions of these guides were based upon holdings in courts and Commission decisions throughout the almost one-half century of the Commission's existence.

The purpose of these guides was the elimination of price comparisons by which the consumer is misled into believing the advertiser has reduced his price or that the consumer is able to buy from a particular advertiser a product for less than what he would pay elsewhere when such statements are contrary to fact.

It was not the purpose in issuing these guides to instruct in lessons of brinkmanship. Neither are these guides rules of law. They are as their name signifies—guides. They are, if you will, codes of ethics for the advertiser of price representations. These guides have been widely distributed both by the Commission and by private interested groups.[6] I am sure you are familiar with their various provisions. There is no necessity, therefore, to review them here.

V.

The guides do list certain phrases held to represent a product's usual and customary retail price. Included among such phrases are "Manufacturer's list price," "Maker's list price," "Manufacturer's suggested retail price." In view of the current and widespread publicity, principally in trade papers, of these phrases, I would like to discuss them with you. Let me again emphasize that I am speaking for myself

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[6] 110,000 copies by the Commission and an estimated additional 500,000 by private sources.

and not officially for the Federal Trade Commission. I do not find any material distinction between these various phrases and in the manner in which they are used. Clearly, there is no distinction between a "list price" and a "suggested list price."

Let me state here and now that within the orbit in which we are considering the problem, there is nothing illegal per se in the mere issuance of a list price or a manufacturer's list price. It only becomes illegal by the use made of such phrases by either the manufacturer or the distributor in advertising directed to the consumer. The test is not the intent of the advertiser, but the understanding of the consumer. The question to be asked and answered is, does the advertising have the capacity to deceive?

It is not even necessary to show that any consumer has, in fact, been deceived by the dealer's use of the suggested list price. The Commission has a right to look at the retailer's advertisements which employ the list prices in juxtaposition with lower offering prices, and in the light of any other relevant evidence and by exercising statutory expertise, decide whether the practice of supplying such prices has the capacity and tendency to deceive.[7]

The Commission has considered the use of "list prices" by manufacturers in advertising directed to consumers, and it has inhibited their use unless they are "bona fide, regularly established selling prices of the products" advertised and offered for sale as established by the usual and customary sales in the normal course of trade.[8]

There is a current case in litigation—the evidence on both sides has been completed—involving the single issue of the manufacturer's use of "list prices." I do not intend to specif-

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7 *Zenith Radio Corp.* v. *F. T. C.*, 143 F. 2d 29, 31 (C. C. A. 7).

8 *The Firestone Tire & Rubber Co., et al.*, Docket 3983; *The Goodyear Tire & Rubber Co., et al.*, Docket 3984; *The B. F. Goodrich Co.*, Docket 3985; 33 F. T. C. 282, *et seq.*; *Montgomery Ward & Co., Inc.*, Docket 8200.

ically discuss the facts in this case,[9] but it has received and is receiving wide publicity, especially in the appliance industry. This case has been called a test case. I do not so consider it a test case.

The Commission, many times, has issued complaints and orders to cease and desist involving preticketed prices by the manufacturer. I do not consider that there is any difference in principle between a list price and a preticketed price. In the former, the list price is usually in the advertising, and in the latter, the price is on the product or on the package. The kind and quality of evidence necessary in both cases are the same.

There is a recent court decision decided in April 1961 by the Court of Appeals for the Seventh Circuit involving a manufacturer of watches and preticketing at fictitious prices.[10] May I quote from that decision.

> " . . . Preticketing at fictitious and excessive prices must be deemed to have the tendency of deceiving the public as to the savings afforded by the purchase of a product thus tagged as well as to the value of the product acquired. Petitioners' practice places a means of misleading the public into the hands of those who ultimately deal with the consumer. Notwithstanding the prevalence of these practices and the familiarity therewith among members of the trade, these activities are proscribed to protect the interest of the public. *Federal Trade Commission* v. *Winsted Hosiery Co.,* 258 U. S. 483, 494 (1922).
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> "Misrepresentation as to the retail value of merchandise by means of an attached, fictitious price and deception as to savings afforded by the purchase of the product at a substantially lower price than that indicated thereon constitute unfair methods of competition. *Niresk*

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[9] *The Regina Corporation, et al.,* Docket 8323.

[10] *The Clinton Watch Company* v. *F. T. C.,* F. T. C. Docket No. 7434 (C. C. A. 7, June 19, 1961).

Industries, Inc. v. *Federal Trade Commission,* 263 F. 2d 396, 397 (2d Cir. 1959)."

VI.

Advertisers should have proof of their price claims. Estimates, guess work, or opinions are not sufficient. The advertiser has the responsibility for the accuracy and proof of comparative prices when he chooses to so advertise.

Any claims which state or imply price reductions from established retail prices should be based on one of two things: (1) The advertiser's own usual and customary price for the specific article in the recent, regular course of business, or (2) the usual and customary retail price of a specific article in the trade area.

These comparative claims must relate to the *specific* article; they must not be based on similar or comparable merchandise. Further, such claims cannot be based on artificial mark-ups or on isolated or infrequent sales of the article.

It is a well-established principle that a deliberate effort to deceive is not necessary to make out a case against unfair methods of competition or deceptive practices within the prohibitions of the Federal Trade Commission Act. In one matter a retailer who was charged with falsely advertising fabrics as woolens defended on the ground that he did not know the advertising claims were false. The Commission held the retailer to be responsible for the claims made in the advertisements published by him, and the Commission's findings were affirmed by the Court of Appeals.[11]

Consequently, a dealer who elects to use comparative prices is presumed to know the ordinary business facts of life concerning what happens to his products and he cannot avoid responsibility if the prices are fictitious by claiming lack of knowledge; he cannot shift all the blame to the manufacturer who gave him the prices.[12]

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11 *Gimbel Brothers* v. *F. T. C.*, 3 S. M. D. 314, 116 F. 2d 578.

12 *The Orloff Company, et al.*, Docket 6184, 52 F. T. C. 709.

The Commission's jurisdiction is limited in this area to practices in interstate commerce. Therefore, as most retailers are engaged in businesses local in nature, there have not been many proceedings against retailers on this point except, of course, in the District of Columbia where the Commission has complete jurisdiction.

The Commission may issue a complaint and order to cease and desist against a retailer who is engaged in commerce and who uses a list price figure in an advertisement published in the retailer's[13] community, wherein the representation is challenged because it does not represent the usual and customary price of the merchandise in that retailer's community.

VII.

Two of the most common arguments presently being made in justification of the use of "list prices" are (1) the "list" prices are necessary to properly identify the product, and (2) reference to the Automobile Information Disclosure Act.

In regard to the first argument: Manufacturers are urged to adopt and consumers are urged to follow other readily available means of identifying merchandise, such as trade names, model numbers, and product descriptions. It is difficult to see how a deceptive price can identify a product in a mondeceptive manner or why it should ever be relied upon to do so.

In regard to the second argument: This argument was advanced by respondents in the Baltimore Luggage Company case now pending on appeal in the Court of Appeals for the Fourth Circuit. The brief for the Commission filed in this matter answers this argument as follows:

> "There is no substance to petitioners' argument that the recent Automobile Information Disclosure Act, 72 Stat. 325 (1953), 15 U. S. C. Secs. 1231-1233, evidences an intent by Congress to permit Baltimore to engage in

13 *Forbes & Wallace, Inc., et al.*, Docket 7474.

preticketing which the Commission has found to be misleading and deceptive. The statute on the contrary was passed to protect purchasers and dealers of automobiles against deceptive pricing practices which had become current among the automobile dealers. Sen. Rep. No. 1555, 85th Cong., 2d Sess. 2-3 (1958). The law is confined to the automobile industry only and deals only with the special problems in that industry. No abridgment of the Commission's broad powers to prevent deception generally is indicated or was intended. Cf. *L. Heller & Son, Inc.* v. *Federal Trade Commission,* 191 F. 2d 954, 957 (7th Cir. 1951)."

VIII.

Another area of difficulty is the use of representations of selling at "wholesale prices" and the representation of trade status of "wholesaler" contrary to fact.

We have found that many of the firms engaged in these practices are actually retailers selling to consumers and they do little or no wholesale selling to retailers. Many of those so engaged are not subject to our jurisdiction. There are four states, Michigan, Minnesota, Oklahoma and Tennessee, that have specific statutes prohibiting the use of words such as "wholesaler," "manufacturer" or similar designations unless the seller is engaged in the represented trade.

The Commission has many times proceeded against this type of misrepresentation, the theory being that the purchasing public regards a wholesaler as one selling to retailers at a price lower than the price at which the retailer sells. The courts have agreed with the Commission's position.[14] The consumers infer from the representation of "wholesale" that they are buying at the prices at which retailers purchase, thereby saving an amount equal to the retailer's profit. When such is not the fact, the consumer-purchaser is deceived.

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14 *L. & C. Mayer Company, Inc.* v. *F. T. C.*, 2 S. & D. 460, 463, 97 F. 2d 365.

There is a second possible violation of laws administered by the Commission in this type of representation. If firms so engaged are actually retailers who represent themselves to manufacturers to be wholesalers and thereby induce a functional discount, they may be in violation of Section 2(f) of the Robinson-Patman Amendment to the Clayton Act. By so misrepresenting their trade status, they may be inducing a discriminatory price to which they are not entitled.

IX.

When the advertiser uses such words as "former," "regular," "usual," etc., in advertising directed to consumers, the Commission has held that they are representations, when used with a price figure, of the advertiser's usual and customary price in the recent, regular course of business.

The "recent, regular course of business" has been defined as the period constituting the current selling season on seasonal goods, e.g., apparel, sporting goods, etc., and not more than 12 months for non-seasonal merchandise such as furniture, jewelry, appliances, etc.

It has been held that the use of the expression "Reg." in connection with an advertisement for the sale of rugs, where such rugs had not been previously sold by the advertiser at the price described as "Reg." was a violation of Section 5 of the Federal Trade Commission Act.[18]

If any claim is based on a past price of the advertiser prior to the recent, regular course of business, that fact should be clearly and adequately disclosed.

X.

The Commission, in December 1959, issued its Guides Against Bait Advertising. The Guides define bait advertising as "an alluring but insincere offer to sell a product or service

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[18] *In the Matter of Bankers Securities Corporation*, D-7039 (1960); *cf.* also *The Fair* v. *F. T. C.*, 272 F. 2d 609 (4th Cir. 1959); *Mandel Bros.* v. *F. T. C.*, 254 F. 2d 118 (7th Cir. 1958).

which the advertiser in truth does not intend or want to sell. Its purpose is to switch consumers from buying the advertised merchandise, in order to sell something else, usually at a higher price or on a basis more advantageous to the advertiser. The primary aim of a bait advertisement is to obtain leads as to persons interested in buying merchandise of the type so advertised."

Sometimes this so-called "bait and switch" operation is difficult to recognize. The whole sales pattern must be examined to determine whether the offer is a bona fide offer to sell the advertised merchandise.

We must distinguish between the salesman's technique of "trading up" and "bait and switch." "Trading up" occurs when the consumer responds to an advertised product and the salesman will advise or suggest a more expensive product. However, in a "trading up" situation the consumer can buy the advertised product if he so desires and the merchant has a quantity of the advertised product in sufficient supply to meet reasonably anticipated demands. This is generally not true in "bait and switch" advertising.

Generally in a bait operation, the advertised product is offered at an extremely low price. This is also true in loss leader situations—the leader is readily sold and its purpose is the hope that the customer will buy other products. Incidentally, the Supreme Court of the United States in dicta had this to say about loss leaders:

> "The selling of selected goods at a loss in order to lure customers into a store is deemed not only a destructive means of competition, but it also plays on the gullibility of customers by leading them to expect what generally was not true, namely that a store which offered such an amazing bargain was full of other such bargains." [16]

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[16] *Safeway Stores* v. *Oklahoma Grocers*, 360 U. S. 334, 340.

XI.

May I conclude. As I indicated my opinion in the beginning of these remarks—the average businessman has ethical standards. He does not desire to measure and determine right from wrong by economic consequences. While he realizes business must have economic efficiency, economic efficiency cannot be the criterion of ethical behavior; because something makes money, it is not necessarily good.

I think most businessmen agree that sound ethics is good business in the long run; this, of course, would include sound, honest, informative retail price advertising.

The unethical business operator might make money for a time, but business cannot mistreat the public for long and still survive. Once stung, the public has a long memory. In the long run, sound ethics not only is good business relations, it is conducive to making money. The real strength of the private enterprise system is that it rewards business over the long term when business is operated not only efficiently but in the best interests of the public.

SOME OBSERVATIONS ON "PER SE" AND TYING ARRANGEMENTS

by

W. L. Baldwin and David McFarland*

Recently, one of the authors was preparing a lecture in which comments were to be made on the use of the doctrine of quantitative substantiality in current interpretation of Section 3 of the Clayton Act. At the same time, our students were reading material which strongly implied that tying arrangement are illegal *per se*. The resulting confusion inspired this joint effort. We would like to point up what we believe to be a misunderstanding about the legal status of tying arrangements. We are not arguing that the courts and lawyers specializing in antitrust matters are in disagreement on this point, but rather that outside of this select circle there is widespread misunderstanding as to whether tying arrangements are illegal *per se*. We would also like to register a plea for more readily comprehensible court decisions. These two aims are very closely related in that the former stems directly from the latter. Finally, we will call attention to the plausible economic argument which often has been made that it would be ill-advised to condemn all tying arrangements regardless of their economic consequences or the underlying intent.

A sampling of recent literature on tying arrangements reveals that while there is no consensus as to their legal status there is frequent acceptance of the position that as the law now stands they are illegal *per se*. Let us cite a few examples. Kaysen and Turner say, "For all practical purposes, tie-in contracts also fall within the select category of practices that are illegal *per se*."[1] According to Donald Dewey,

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1 Carl Kaysen and Donald F. Turner, *Antitrust Policy: An Economic and Legal Analysis* (Cambridge: Harvard University Press, 1959), p. 146.

"Tying contracts have been made virtually per se violations of the antitrust laws on the assumption that they serve 'hardly any purpose beyond the suppression of competition.'"[2] Edward S. Mason says flatly that "The tying contract has clearly become illegal *per se*."[3] Others are somewhat more reserved in their interpretation of the Court's language. Bain, for example, says that they have "not generally been found illegal if a number of sellers in an industry all follow the same policy in competition with each other."[4] Ward Bowman, commenting on tying arrangements involving unpatented products, states that "the per se rule has no application here."[5]

Tying arrangements are conditions of sale or lease which the seller attaches to one of his products. Under these conditions the buyer is required to buy a second or "tied" product as a condition for being allowed to buy or lease the more desirable or "tying" product. The tying product is often a patented item or one highly differentiated through advertising by the seller.

This misunderstanding, we believe, is purely a problem of semantics which derives from the Court's failure to adhere to the accepted usage of the term *"per se."* The Court's language in tying arrangement cases is responsible for the conclusion that such arrangements are illegal on their face just as are price-fixing agreements. In fact the Court has not held this at all. To the contrary, the Court has upheld tying arrangements where the manufacturer has contended that the use of the tied product is necessary to protect his stake

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[2] Donald Dewey, *Monopoly in Economics and Law* (Chicago: Rand McNally & Company, 1959), p. 206.

[3] Edward S. Mason, *Economic Concentration and the Monopoly Problem* (Cambridge: Harvard University Press, 1957), p. 397.

[4] Joe S. Bain, *Industrial Organization* (New York: John Wiley & Sons, Inc., 1959), p. 330.

[5] Ward S. Bowman, Jr., "Tying Arrangements and the Leverage Problem," 67 *Yale Law Journal* 19 (November 1957), p. 31.

in the reputation of the tying product.[6] The leading cases in the evolution of the law are *International Salt,*[7] *Standard Oil,*[8] *Times-Picayune,*[9] and *Northern Pacific.*[10] In striking down a tying arrangement employed by Northern Pacific the Supreme Court couched its opinion in language that epitomizes the semantic difficulty which concerns us. "[W]e are convinced that the essential prerequisites for treating the defendant's tying arrangements as unreasonable *'per se'* were conclusively established below and that the defendant has offered to prove nothing there or here which would alter this conclusion." [11] If the term *"per se"* is to be taken in its accepted usage, i.e., according to the definition given in *Corpus Juris Secundum,* there would be only one way for the defendant to alter the courts' conclusion and that would be to prove that it did not in fact engage in the tying arrangement. "The literal meaning of the term 'per se' is by itself; in itself; of itself; simply as such; in its own nature without reference to its relation; and according to other authorities on the question, taken alone. It is also defined as meaning intrinsically, essentially, directly." [12] This, we believe, means that if an act is declared illegal *per se,* the Court need only be shown that the act itself was committed. If tying arrangements are illegal *per se* the plaintiff need only prove that such an arrangement existed. It should not be necessary to show that there was monopoly in the tying product, that competitors were foreclosed from a substantial market, or any other "essential prerequisites."

The reasoning by which one might logically conclude that tying arrangements are illegal *per se* may loosely be put in

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6 See for example, *Miller Motors, Inc.* v. *Ford Motor Company,* 149 F. Supp. 790 (1957).

7 *International Salt Co.* v. *United States,* 332 U. S. 392 (1947).

8 *Standard Oil Company of California* v. *United States,* 337 U. S. 293 (1949).

9 *Times-Picayune Publishing Co.* v. *United States,* 345 U. S. 594 (1953).

10 *Northern Pacific Railway Co.* v. *United States,* 356 U. S. 1 (1957).

11 *Ibid.,* p. 8.

12 *Corpus Juris Secundum,* Vol. 70, pp. 447-48.

the form of a syllogism drawn from the Court's rulings. Major premise: it is illegal *per se* to foreclose competitors from a substantial market (*International Salt*). Minor premise: tying arrangements have "hardly any purpose" [13] but to foreclose competitors from a substantial market (*Standard Oil*). Conclusion: tying arrangements are illegal *per se* (*Northern Pacific*). But, "every lawyer must acknowledge that the law is not always logical at all." [14]

Justice Harlan, dissenting in the *Northern Pacific* decision, commented "the Court intimates at one point in its opinion, that under the Sherman Act the tying clause is illegal *per se*." [15] As we read the opinions, the evolution culminating in *Northern Pacific* is roughly as follows. In the *International Salt* case the Court concluded from the facts in evidence that a tying arrangement which required users of International Salt's dispensing machines to buy their salt from International Salt had the effect of foreclosing competitors from a substantial market. Such foreclosure had earlier been held to be illegal *per se* so the contested arrangement failed. Later, in *Standard Oil,* the Court made a similar finding with respect to tied purchases of petroleum products and automobile accessories, and went on to generalize that, "Tying agreements serve hardly any purpose beyond the suppression of competition. . . . In the usual case only the prospect of reducing competition would persuade a seller to adopt such a contract and only his control of the supply of the tying device, whether conferred by patent monopoly or otherwise obtained, could induce a buyer to enter one." [16] It was, we believe, this generalization of a specific finding that led the Court in *Northern Pacific* to refer to "the rule of *per se* unreasonableness laid down in International Salt," [17] and to

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[13] 337 U. S. 293 at p. 305.

[14] A statement by Lord Halsbury in *Quinn* v. *Leathem*, 1901, A. C. 495, 506, as quoted by Justice Cardozo in *The Nature of the Judicial Process* (New Haven: Yale University Press, 1921), p. 32.

[15] 356 U. S. 1, at p. 14.

[16] 337 U. S. 293, at pp. 305-06.

[17] 356 U. S. 1, at p. 9.

leave the impression that tying arrangements are henceforth illegal *per se*. But the language used in denying that the *Times-Picayune* case retreated from the *International Salt* rule should make it clear that the Court's usage of *per se* is not the same as that of *Corpus Juris Secundum*. "While there is some language in the *Times-Picayune* opinion which speaks of 'monopoly power' or 'dominance' over the tying product as a necessary precondition for application of the rule of *per se* unreasonableness to tying arrangements, we do not construe this general language as requiring anything more than sufficient economic power to impose an appreciable restraint on free competition in the tied product (assuming all the time, of course, that a 'not insubstantial' amount of interstate commerce is affected)." [18]

The Court has assumed that tying clauses rarely serve any other purpose than suppression of competition and extension of monopolistic power into the market for the tied product. But, as several writers have demonstrated, this assumption is unwarranted. Bowman, for example, argues that a monopolist who is already charging a profit-maximizing price for the tying product may find it quite difficult to impose new restraints on his customers without losing as much or more in sales of the tying product as he gains from increased profits in the tied product. Indeed, Bowman notes that cases brought before the courts indicate that tying clauses may be designed merely to require customers who buy or rent patented machines to pay in proportion to the use they make of the machines through excessively high prices for tied products such as buttons or staples in which the quantities consumed vary directly with use of the tying devices.[19] In all likelihood, such discriminatory pricing would not be regarded as abusive of the patent monopoly if the charges were computed by means of a mechanical counter attached to the patented product, and the result is in no way different merely

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[18] *Ibid.*, p. 11.

[19] Bowman, *op. cit.*, p. 19.

because the seller chooses to use the tying-clause device instead.

Dirlan and Kahn comment, "The seller who says 'I'll let you have this if you'll buy that,' may be merely competing for customers, the tie-in serving as the same kind of inducement as a price concession. It is difficult in this case to see how anybody is excluded from the tied-in market, in any meaningful sense. Indeed, a tie-in is not necessarily an exclusive arrangement at all."[20] This suggests the possibility that the tie-in arrangement is disguised price competition, reflecting the existence of bargaining power on the part of the buyer or secret and sporadic price cutting of the sort J. M. Clark has described as enhancing workable competition,[21] and conceivably lessening the market power connected with the tying product. Donald Dewey has noted that tying contracts may represent a "rudimentary form of vertical integration in marketing," and may therefore lead to genuine economies of scale in both manufacture and distribution. As an instance in which a tying arrangement may have been motivated only by patriotism, Dewey cites the *Gratz* case wherein the offender had tied sales of steel ties to sales of bagging in order to prevent World War I hoarders from purchasing excessive quantities of the former.[22] Finally, tying arrangements could be used by an aggressive newcomer to overcome barriers to entry into the market for the tied product, and they might be used in this fashion to reduce rather than enhance existing monopolistic power.

We do not contend that tying arrangements are justified in the majority of cases. But their conceivable uses are so

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[20] Joel B. Dirlam and Alfred E. Kahn, *Fair Competition* (Ithaca: Cornell University Press, 1954), pp. 189-90.

[21] J. M. Clark, "Toward a Concept of Workable Competition," *American Economic Review*, Vol. XXX (June 1940), pp. 241-56.

[22] Dewey, *op. cit.*, pp. 200-05. For further material on the justification of tying arrangements the reader is referred to G. E. Hale and Rosemary D. Hale, *Market Power: Size and Shape Under the Sherman Act* (Boston-Toronto: Little, Brown and Company, 1958), pp. 52-58.

varied that the courts should examine each and every tying arrangement on its own merits rather than condemn all on an unwarranted *a priori* assumption.

We have argued that the Court does not mean that tying arrangements are illegal in and of themselves when it says that they are illegal *per se*. It has been shown that even though the Court says *"per se"*, it proceeds to examine the attendant circumstances to determine whether the acts in question constitute violations. We would argue that such a policy is economically sound. Moreover, according to Lindahl and Carter, "Congress did not intend to condemn all tying contracts."[23] The theory behind *per se* is that certain acts, price fixing for example, have such obvious anticompetitive purposes that it is unnecessary to look into the intent of the firms engaging in them. If the "nature and baneful effects of tying arrangements and their incompatibility with the policies underlying the Sherman Act"[24] were as clear as the effects are in the case of price-fixing agreements we would be quite content to have tying arrangements banned by the same inflexible rule. We have attempted to show that there are circumstances wherein tying arrangements are economically defensible. In view of this we would favor application of a rule of reason test in Sherman Act cases. When the offense is charged under Section 3 of the Clayton Act, the burden should be on the government to demonstrate a reasonable probability that there will be a substantial lessening of competition or a tendency toward monopoly rather than a mere showing that "a substantial volume of commerce in the 'tied' product is restrained."[25]

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[23] Martin L. Lindahl and William A. Carter, *Corporate Concentration and Public Policy*, third edition (Englewood Cliffs: Prentice-Hall, Inc., 1959), p. 595.

[24] 356 U. S. 1, at p. 11.

[25] 345 U. S. 594, at p. 608.

THE USE OF GOVERNMENT JUDGMENTS OR DECREES IN SUBSEQUENT TREBLE DAMAGE ACTIONS UNDER THE ANTITRUST LAWS*

by

E. COMPTON TIMBERLAKE**

In recent years there has been a tremendous increase in the number of antitrust actions, both government and private. For example, in 1959 a total of 315 antitrust suits were filed, of which 63 were government antitrust proceedings.[1] At the end of 1959 there were 600 private antitrust actions and 93 government actions pending.[2] The increase in government litigation[3] will undoubtedly result in a further increase in the number of private treble damage actions.

The substantially larger number of private antitrust actions, many of which have followed in the wake of litigated government actions, has given greater importance to Section 5 of the Clayton Act,[4] which authorizes, under certain circumstances, the admission of a prior judgment or decree entered in a government action. "A government [antitrust] suit, while primarily in the public interest, if successful, also accrues to the immediate benefit of those injured by the wrongful conduct."[5] It is apparent that a judgment or decree from a government action, when introduced before a jury of laymen

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1 *1960 Antitrust Law Symposium*, "New Theories of Federal Trade Commission Enforcement," 2.

2 *Ibid.*

3 In his 1959 year-end report, then Acting Assistant Attorney General Bicks said: "With the perspective of a decade . . . this year's record of 63 cases spells a more than 50% increase in new proceedings." *Id.* at 4.

4 69 Stat. 283 (1955), 15 U. S. C. §16 (1958), amending 38 Stat. 731 (1914).

5 *T. C. Theatre Corp.* v. *Warner Bros. Pictures, Inc.*, 113 F. Supp. 265, 269 (S. D. N. Y. 1953).

in a subsequent treble damage action, constitutes evidence of considerable prejudicial force.[6] In order to safeguard the rights of defendants, it is of the utmost importance that the use of the prior judgment or decree be carefully controlled by the trial judge and that it be permitted in evidence only in a proper case.[7]

At the outset, it seems important to review briefly the nature of the private action for damages under the antitrust laws. The action is grounded upon Section 4 of the Clayton Act, which provides that a person injured in his business or property may recover three times the amount of his damage.[8] The gist of a private action for treble damages is the injury to plaintiff's business or property directly and proximately caused by the violation of the antitrust laws.[9] The "mere existence of a violation is not sufficient ipso facto to support the action."[10] "A private person has no right to complain of a violation of §1 or §2, as such, nor does such a violation per se give rise to a private cause of action" and "consequently, forbidden acts cannot be relevant unless they *cause* private damage."[11] "It matters not that certain of the defendants have violated the provisions of the Sherman Act unless

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[6] *Monticello Tobacco Co.* v. *American Tobacco Co.*, 197 F. 2d 629, 633 (2d Cir.), cert. denied, 344 U. S. 875 (1952).

[7] Circuit Judge A. N. Hand has said: "This business of using a pretty obscure decree and decisions, as they have tried to do before, to lick somebody in litigation between themselves and other parties is crude judicial stuff, from the point of view of a judge, very, very crude stuff." Record, p. 921, *United States* v. *Loew's, Inc.*, Equity No. 87-273, S. D. N. Y., Hearing on Jan. 18, 1950.

[8] "Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee." 38 Stat. 731 (1914), 15 U. S. C. §15 (1958).

[9] *Shotkin* v. *General Elec. Co.*, 171 F. 2d 236, 238-39 (10th Cir. 1948); *Foster & Kleiser Co.* v. *Special Site Sign Co.*, 85 F. 2d 742, 750-51 (9th Cir. 1936), cert. denied, 299 U. S. 613 (1937); *Myers* v. *Shell Oil Co.*, 96 F. Supp. 670, 674 (S. D. Cal. 1951).

[10] *Beegle* v. *Thomson*, 138 F. 2d 875, 881 (7th Cir. 1943), cert. denied, 322 U. S. 743 (1944).

[11] *Wolfe* v. *National Lead Co.*, 15 F. R. D. 61, 63 (N. D. Cal. 1953).

it be proved that such acts have injured the plaintiffs and caused them damages which can be recovered in an action at law."[12] Thus, it is clear that a private claim under the antitrust laws can be only for legal injury resulting from a violation of law.[13]

The causal connection between the conspiracy or violation of law and the legal injury to plaintiff's business or property is an indispensable part of the plaintiff's private action for damages. This basic principle has been stated in several different ways: (1) a mere conspiracy does not give rise to a claim for damages;[14] (2) in a private treble damage action the principal element is not the conspiracy but the acts in furtherance thereof which directly caused injury to the plaintiff;[15] and, (3) a plaintiff may not recover by proving merely some incidental or indirect injury flowing from the illegal acts of the defendant, but he must prove an act prohibited by the statute committed during the existence of his business which injured his business or property.[16]

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12 *Locker* v. *American Tobacco Co.*, 218 Fed. 447, 448 (2d Cir. 1914). Accord, *Glenn Coal Co.* v. *Dickinson Fuel Co.*, 72 F. 2d 885, 887 (4th Cir. 1934); *Jack* v. *Armour & Co.*, 291 Fed. 741, 745 (8th Cir. 1923).

13 *Monticello Tobacco Co.* v. *American Tobacco Co.*, 197 F. 2d 629 (2d Cir.), cert. denied, 344 U. S. 875 (1952); *Turner Glass Corp.* v. *Hartford-Empire Co.*, 173 F. 2d 49 (7th Cir.), cert. denied, 338 U. S. 830 (1949); *Wolfe* v. *National Lead Co.*, 15 F. R. D. 61, 63 (N. D. Cal. 1953); *Quittner* v. *Motion Picture Producers & Distribs. of America*, 50 F. 2d 266 (S. D. N. Y. 1931).

14 *Glenn Coal Co.* v. *Dickinson Fuel Co.*, 72 F. 2d 885, 887 (4th Cir. 1934); *Jack* v. *Armour & Co.*, 291 Fed. 741, 745 (8th Cir. 1923); *Loeb* v. *Eastman Kodak Co.*, 183 Fed. 704, 709 (3d Cir. 1910); *Mid-West Theatres Co.* v. *Co-Operative Theatres*, 43 F. Supp. 216, 220 (E. D. Mich. 1941); *Ebeling* v. *Foster & Kleiser Co.*, 12 F. Supp. 489, 490 (W. D. Wash. 1935).

15 *Williamson* v. *Columbia Gas & Elec. Corp.*, 186 F. 2d 464, 468 (3d Cir. 1950), cert. denied, 341 U. S. 921 (1951); *Suckow Borax Mines Consol., Inc.* v. *Borax Consol., Ltd.*, 185 F. 2d 196, 208 (9th Cir. 1950), cert. denied, 340 U. S. 943 (1951); *Burnham Chem. Co.* v. *Borax Consol., Ltd.*, 170 F. 2d 569, 571 (9th Cir. 1948), cert. denied, 336 U. S. 924 (1949); *Levy* v. *Paramount Pictures*, 104 F. Supp. 787 (N. D. Cal. 1952); *Momand* v. *Universal Film Exch., Inc.*, 43 F. Supp. 996, 1007 (D. Mass. 1942), aff'd, 172 F. 2d 37 (1st Cir. 1948), cert. denied, 336 U. S. 967 (1949).

16 *Conference of Studio Unions* v. *Loew's Inc.*, 193 F. 2d 51 (9th Cir. 1951), cert. denied, 342 U. S. 919 (1952); *Tilden* v. *Quaker Oats Co.*, 1 F. 2d 160, 164 (7th Cir. 1924); *Loeb* v. *Eastman Kodak Co.*, 183 Fed. 704 (3d Cir. 1910); *Gerli* v. *Silk Ass'n of America*, 36 F. 2d 959 (S. D. N. Y. 1929).

That a company has been found to have violated the antitrust laws is not a relevant fact in a private treble damage action, unless the private litigant was injured by *that violation.*[17] In a case where plaintiff sought treble damages on the basis of antitrust violations occurring prior to the time plaintiff commenced business, Mr. Justice Holmes spoke for a unanimous Court using the picturesque language: "The plaintiff could not be called into being in order to maintain a suit for conduct that made it not pay to be born. Claims for such antenatal detriments are not much favored by the law." [18]

One of the first inquiries is to determine whether the legal injury, for which damages are sought in the private action, was inflicted on the plaintiff in the private action as the direct and proximate result of the same violation of the antitrust laws as that found in the prior government action. If the court makes a preliminary finding that the prior adjudicated violation was not the cause of injury to the private plaintiff, then the decree is not relevant.[19] The mere fact of prior conviction does not make the defendants in the government action liable for every business casualty in the industry[20] and

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17 *Monticello Tobacco Co.* v. *American Tobacco Co.*, 197 F. 2d 629, 631 (2d Cir.), cert. denied, 344 U. S. 875 (1952). See *Shotkin* v. *General Elec. Co.*, 171 F. 2d 236, 238 (10th Cir. 1948).

18 *Buckeye Powder Co.* v. *E. I. DuPont De Nemours Powder Co.*, 248 U. S. 55, 64 (1918).

19 *Eagle Lion Studios, Inc.* v. *Loew's, Inc.*, 248 F. 2d 438 (2d Cir. 1957), aff'd mem. by an equally divided Court, 358 U. S. 100 (1958). The court, finding the prior decree to be irrelevant and hence inadmissible, said: "Applying these principles to the Paramount judgment we conclude that the issue here in suit was not 'distinctly determined' in the Paramount litigation. . . . In short, we must look elsewhere if we are to find any evidence of the conspiracy that the plaintiffs here charge." *Id.* at 444-45. In *Hillside Amusement Co.* v. *Warner Bros. Pictures Distrib. Corp.*, Civil No. 50-183, S. D. N. Y., May 7, 1953, aff'd, 224 F. 2d 629 (2d Cir. 1955), Judge Sugarman said: "I say it is not relevant, and I do not think the Paramount decree is relevant in this case, because the decision will very clearly show that on the question of rentals, while the Court expressed a vague notion that there was something to it, they specifically excluded it from the Paramount decree. So anything they held in the Paramount case you are not going to hitch your wagon on to that star." Record, vol. 1, p. 294, *ibid.*

20 *Monticello Tobacco Co.* v. *American Tobacco Co.*, 197 F. 2d 629, 631 (2d Cir.), cert. denied, 344 U. S. 875 (1952).

the courts should hold the plaintiff strictly to a demonstration of logical and probative relevance; mere allegations are insufficient. In addition, a private litigant does not have a cause of action for violation of a government decree, and it is not relevant or proper for a private plaintiff to prove a violation of the prior decree.[21]

If the court concludes that the prior decree may be relevant in the private action, the court must then determine that the decree complies with the requirements of section 5 before it may be admitted in evidence. There must be strict compliance for it is clear that no decree in any antecedent government antitrust proceeding would be admissible in a private treble damage action, but for the provisions of Section 5 of the Clayton Act.[22] Under this section, before the judgment or decree is admissible in the private suit it must be final and must hold that the defendant violated the antitrust laws. Further, the judgment or decree is admissible only as to matters respecting which the parties thereto would be estopped. A proviso clause makes section 5 inapplicable to consent judgments or decrees entered before any testimony has been taken.[23]

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[21] *Independent Theatres, Inc.* v. *American Broadcasting-Paramount Theatres, Inc.*, 179 F. Supp. 489, 490 (S. D. N. Y. 1959), in which Judge Weinfeld said: "Plaintiff's claim must rest upon alleged violation of the antitrust statutes and not upon any claimed violation of the decree." Accord, *Brownlee* v. *Malco Theatres*, 99 F. Supp. 312, 317 (W. D. Ark. 1951). Cf. *Craig* v. *Leitensdorfer*, 123 U. S. 189, 206-07 (1887) (stranger to an *in personam* action unable collaterally to attack fraudulently procured decree); *Winkler-Koch Eng'r Co.* v. *Universal Oil Prods. Co.*, 79 F. Supp. 1013 (S. D. N. Y. 1947) (plaintiff in treble damage suit not a party to a settlement unable to admit evidence of fraud in procurement of the settlement); Restatement, Judgments §93 (1942) (one not a party or privy not entitled to benefits of an adjudication).

[22] See *Buckeye Powder Co.* v. *E. I. DuPont De Nemours Powder Co.*, 248 U. S. 55, 63 (1918).

[23] "A final judgment or decree heretofore or hereafter rendered in any civil or criminal proceeding brought by or on behalf of the United States under the antitrust laws to the effect that a defendant has violated said laws shall be prima facie evidence against such defendant in any action or proceeding brought by any other party against such defendant under said laws . . . as to all matters respecting which said judgment or decree would be an estoppel as between the parties thereto: *Provided*, That this section shall not apply to consent judgments or decrees entered before any testimony has been taken. . . ." 69 Stat. 283 (1955), 15 U. S. C. §16(a) (1958), amending 38 Stat. 731 (1914).

Little time need be spent defining a final judgment or decree, since it is generally accepted as the pronouncement of a court of last resort or, if no appeal is taken, the judgment or decree of the trial court. Where an appeal is pending, the judgment or decree is not final and may not be used as prima facie evidence.[24] Nor need much time be spent on consent judgments or decrees entered before the taking of any testimony. This proviso of the statute clearly applies to civil cases and to *nolo contendere* pleas in criminal actions,[25] but there may be some doubt that the proviso covers a plea of guilty in a criminal case.[26]

Consent decrees entered after an appeal, but before the taking of any testimony on the remand, have occasioned more difficulty; however, it is believed that the taking of any testimony is sufficient to make the proviso inapplicable. Therefore, since the purpose of the proviso is to induce defendants to prompt capitulation, and the proceedings on remand are deemed a mere continuation of the previous trial rather than a trial de novo, the decree is admissible where any testimony has been heard at the previous trial.[27] Where such a decree has been excluded, it has been on the theory that the appeal vacated any estoppel between the parties.[28]

The major area of conflict has been in determining and applying the tests of estoppel. The Supreme Court has made it clear that the "evidentiary use which may be made under

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24 *Fifth & Walnut, Inc.* v. *Loew's, Inc.*, 176 F. 2d 587, 592-94 (2d Cir.), cert. denied, 338 U. S. 894 (1949); *Duluth Theatre Corp.* v. *Paramount Pictures*, 72 F. Supp. 625 (D. Minn. 1947); *Twin Ports Oil Co.* v. *Pure Oil Co.*, 26 F. Supp. 366, 368-70 (D. Minn. 1939).

25 *Twin Ports Oil Co.* v. *Pure Oil Co.*, 26 F. Supp. 366 (D. Minn. 1939); *Pfotzer* v. *Aqua Systems, Inc.*, 162 F. 2d 779, 784 (2d Cir. 1947) (dictum).

26 The pertinent legislative debate is summarized in *Twin Ports Oil Co.* v. *Pure Oil Co.*, *supra* note 25, at 374-76. In that case Judge Nordbye concluded that "in the latter part of the debate, no one questioned that a judgment based on a plea of guilty or plea of nolo contendere would be within the proviso." *Id.* at 376.

27 *Homewood Theatre, Inc.* v. *Loew's, Inc.*, 110 F. Supp. 398, 410 (D. Minn. 1952); *De Luxe Theatre Corp.* v. *Balaban & Katz Corp.*, 95 F. Supp. 983 (N. D. Ill. 1951).

28 See Record, vol. 36, *Applebaum* v. *Paramount Pictures, Inc.*, Civil No. 373, S. D. Miss. 1951 (semble).

§5 of the prior conviction" (or decree) is "to be determined by reference to the general doctrine of estoppel. . . . Such estoppel extends only to questions 'distinctly put in issue and directly determined' in the criminal prosecution" (or equity proceeding).[29] The Clayton Act, in addition to the provisions governing the admissibility of decrees, also provides that the running of the statute of limitations shall be tolled during the pendency of the government action and for one year thereafter.[30] Thus, a private litigant injured by a violation of the antitrust laws may wait until the government suit involving the matter is concluded and then bring his action using the government decree, without any concern that the statute of limitations would bar his lawsuit.[31]

Where the plaintiff in the private litigation has testified for the Government in the prior litigation, so that the basic claim which he advances in the private suit was in fact a part of the Government's case, there exists the factual situation actually contemplated by section 5. This was the situation presented to the Supreme Court in *Emich Motors Corp.* v. *General Motors Corp.*[32] Emich testified in the government action as to his difficulties arising from his failure to finance cars through GMAC. After the final judgment in the government action, Emich filed his action for treble damages. The Supreme Court held that plaintiffs were entitled "to intro-

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[29] *Emich Motors Corp.* v. *General Motors Corp.*, 340 U. S. 558, 568-69 (1951). See *United States* v. *International Bldg. Co.*, 345 U. S. 502 (1953); *Cromwell* v. *County of Sac*, 94 U. S. 351, 352-53 (1876). In *Mercoid Corp.* v. *Mid-Continent Inv. Co.*, 320 U. S. 661, 671 (1944), the Supreme Court said: "[T]he prior judgment is *res judicata* not as to the issues which might have been tendered but 'only as to those matters in issue or points controverted, upon the determination of which the finding or verdict was rendered.'" See also *Partmar Corp.* v. *Paramount Pictures Theatres Corp.*, 347 U. S. 89, 102 (1954).

[30] 69 Stat. 283 (1955), 15 U. S. C. §16 (1958), amending 38 Stat. 731 (1914).

[31] Section 5 of the Clayton Act was adopted in response to a recommendation by President Wilson that Congress "agree in giving private individuals . . . the right to found their [antitrust] suits for redress upon the facts and judgments proved and entered in suits by the Government where the Government has . . . sued the combinations complained of and won its suit. . . ." 51 Cong. Rec. 1964 (1914).

[32] 340 U. S. 558 (1951).

duce the prior judgment to establish prima facie all matters of fact and law necessarily decided by the conviction and the verdict on which it was based." [33] As to the troublesome question of what was adjudicated in the prior case, the Supreme Court said that this "must be determined by the trial judge hearing the treble-damage suit, upon an examination of the record, including the pleadings, the evidence submitted, the instructions under which the jury arrived at its verdict, and any opinions of the courts." [34] This is by no means an easy task and it is one which has in some cases required considerable time of the trial judge.

Frequently, great difficulty is encountered in determining whether the judgment or decree is admissible and, if so, the scope of the estoppel. This is particularly the case where the plaintiff in the private action was not a witness for the Government or where the judgments or decrees are general in nature. In order properly to solve that type of problem, it is necessary to apply the principles of estoppel. Two issues are involved: (1) What matters were distinctly put in issue and directly determined in the government action?[35] (2) Is the matter which was dictinctly put in issue and directly determined in the government action an ultimate fact in the private action?[36]

It seems that the first inquiry should be to determine what was distinctly put in issue and directly determined in the government action. This can only be done by counsel's putting before the court, with appropriate briefs, such portions of the government case as may be necessary to decide what violations of law were directly determined in the government action.[37] No one can expect a busy trial judge personally to

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[33] *Id.* at 569.

[34] *Ibid.*

[35] See note 29 *supra* and accompanying text; 1 Freeman, Judgments §§257-59 (4th ed. 1892); Restatement, Judgments §§68(1)-(2) (1942).

[36] Restatement, Judgments §68, comment p (Supp. 1948). But *cf.* 36 *N. Y. U. L. Rev.* 522, 523 & n. 10 (1961).

[37] See *Emich Motors Corp.* v. *General Motors Corp.*, 340 U. S. 558, 569 (1951).

collect the necessary papers and give them appropriate study, without full assistance from counsel. Even where full assistance is given by counsel, the resolution of this problem lengthens the time needed to dispose of the all too time-consuming litigation of this nature. Since plaintiff bears the burden of proof, it certainly is not too much to expect that it should bear the burden of establishing prima facie the admissibility of such evidence. In determining what was distinctly put in issue and directly determined in the prior government action, the court is not at liberty to draw inferences from the prior judgment.[38]

Generally the question of admissibility of the prior judgment or decree can best be determined after the evidence has developed. "The broader view of a cause afforded by evidence is almost indispensable to the proper administration of justice when deciding an issue as important as this."[39] A great deal of time and effort can be wasted by the trial court and counsel if an attempt is made to ascertain what was decided in the prior government action before the issues in the private action have been narrowed, defined and delineated.[40] If the

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[38] In *Eagle Lion Studios, Inc.* v. *Loew's, Inc.*, 248 F. 2d 438 (2d Cir. 1957), aff'd mem. by an equally divided Court, 358 U. S. 100 (1958), the court rejected plaintiff's argument that its construction of the findings in a prior decree was the only fair inference to be drawn therefrom: "In determining . . . the effect of a judgment in a prior anti-trust suit it is not our function to consider inferences, whether reasonable ones or not, that might be drawn from the language of the prior judgment. . . . [T]he court in the subsequent action does not sit as a trier of fact, *i.e.*, it does not have wide license to draw inferences from the judgment and record in the prior litigation. Rather, the court is circumscribed by the relatively narrow limits of the doctrine of estoppel.

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. . . It is true that where a question of fact essential to the judgment is actually litigated and determined by a valid and final judgment, the determination is conclusive between the parties in a subsequent action on a different cause of action. But 'a judgment on one cause of action is not conclusive in a subsequent action on a different cause of action as to questions of fact *not actually litigated and determined in the first action.*'" *Id.* at 444, quoting Restatement, Judgments §68(2) (1942). (Emphasis added by court.)

[39] *Wolfe* v. *National Lead Co.*, 15 F. R. D. 61, 63 (N. D. Cal. 1953).

[40] See Report of the Judicial Conference Study Group on Procedure in Protracted Litigation, Handbook of Recommended Procedures for the Trial of Protracted Cases, 25 F. R. D. 351 (1960).

issues in the private action have been clearly defined, then the search of the prior government proceeding can be limited to those matters relevant to the private action. This may well be a much less onerous task than would be involved if another approach were taken, since only those matters involved in the private action need be considered. The time when the prior judgment or decree is to be admitted rests in the sound discretion of the trial judge and deferring a decision on the important question of admissibility of prior decrees is not prejudicial to either party. Summarily dismissing an assignment of error predicated upon the refusal of the trial judge to admit a prior criminal judgment unqualifiedly and at the inception of the trial, the Second Circuit pointed out that "it was certainly within his discretion to control the order of proof, . . . a discretion to be carefully exercised in regard to evidence of such slight probative value, but potentially high emotive impact on a jury of laymen." [41]

While the type of analysis which must be applied to the prior government litigation will vary from case to case, the parties should pay particular attention to the time period involved, the identity of defendants, the locality and products involved and the issues. Each of these factors is of major importance in deciding admissibility of the decree in the private action, and, if it is admissible, the type of instruction to be given the jury.

Where the time period involved in the private action is within the time period to which the adjudication in the government case relates, there is little difficulty with this aspect of the estoppel. This seems to be the classic situation envisioned by section 5. A more troublesome question arises where the period of time involved in the treble damage action overlaps the period of time to which the adjudication in the government suit related. If the period for which damages are claimed in the private action includes a portion of the time as to which the government action also related, and, if

[41] *Monticello Tobacco Co.* v. *American Tobacco Co.*, 197 F. 2d 629, 633 (2d Cir.), cert. denied, 344 U. S. 875 (1952).

the decree is otherwise held admissible, some courts have solved the question by instructions which limit the time as to which the estoppel is effective. An example of this type of instruction is: "The Court further charges you on the prima facie effect of the Paramount decree in this case that it must necessarily be limited to the time considered by the Court in that case and therefore is limited in time to 1945 and prior, and plaintiffs can derive no aid from that decree subsequent to 1945 . . . "[42]

Where the private action involves a time period which is subsequent to that involved in the prior government action, there has been considerable confusion in the rulings on admissibility. Before discussing the problem further, it would seem appropriate to restate certain fundamental principles. It seems well settled that a change in circumstances created by the passage of time prevents the creation of an estoppel.[43] Similarly, matters adjudicated as to one period of time are not an estoppel as to other periods of time.[44] "A question cannot be held to have been adjudged before an issue on the subject could possibly have arisen."[45]

The difference in the time periods involved has been a determining factor in the rejection of prior decrees in certain private treble damage actions.[46] One court stated that the

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[42] Charge given on October 21, 1954, by Judge Whitehurst in *Claughton* v. *Paramount Film Distrib. Corp.*, S. D. Fla., Oct. 22, 1954 (copy in author's files). The damage period was 1942 to 1951.

[43] See, e.g., *City of Shreveport* v. *Shreveport Ry.*, 38 F. 2d 945 (5th Cir.), cert. denied, 281 U. S. 763 (1930).

[44] *Local 167, Int'l Bhd. of Teamsters* v. *United States*, 291 U. S. 293 (1934) (estoppel applied within the period covered by the indictment). Cf. *Commissioner* v. *Sunnen*, 333 U. S. 591, 602 (1948).

[45] *Third Nat'l Bank* v. *Stone*, 174 U. S. 432, 434 (1899).

[46] *Park Neponset Corp.* v. *Smith*, 258 F. 2d 452 (1st Cir. 1958); *Paramount Film Distrib. Corp.* v. *Village Theatre, Inc.*, 228 F. 2d 721, 726-27 (10th Cir. 1955); *Robbinsdale Amusement Corp.* v. *Warner Bros. Pictures Distrib. Corp.*, 141 F. Supp. 134, 143 (D. Minn. 1955). In *Orbo Theatre Corp.* v. *Loew's, Inc.*, 156 F. Supp. 770, 777 (D. D. C. 1957), aff'd, 261 F. 2d 380 (D. C. Cir. 1958), cert. denied, 359 U. S. 943 (1959), the court rejected the decrees from the prior government action, saying: "The decrees in the Paramount case were made in 1950. The alleged conspiracy, of which

prior government judgment "was long prior to the time plaintiff entered business at Denver and it had no bearing whatever upon any justiciable issue appropriate for determination in this case." [47]

Some plaintiffs have contended that *Theatre Enterprises, Inc.* v. *Paramount Film Distributing Corp.*[48] approved the introduction of a prior government decree in a private treble damage action involving a period of time subsequent to that in the government action. This contention misreads the holding of that case. There plaintiff sought treble damages allegedly resulting from a conspiracy to deprive its Crest Theatre in Baltimore of an opportunity to exhibit motion pictures on first run. That theatre opened in February, 1949 and the action was commenced in March, 1950. The trial court admitted excerpts from the decrees in *United States* v. *Paramount Pictures, Inc.*[49] and objections were taken by all parties. The jury returned a verdict for the defendants. On appeal plaintiff argued that the handling of the decrees deprived it of the benefits of section 5. The defendants argued that the decrees were not admissible at all in that, among other things, the *Paramount* case adjudicated facts as of 1945 and prior, and, in any event, plaintiff received as much as it was entitled to receive. In affirming, the Supreme Court decided only the narrow question presented and merely held "that petitioner was entitled to no greater benefit than the trial judge gave it." *Theatre Enterprises* should not be read as approving the admission into evidence of a government decree as prima facie evidence of a conspiracy at a period of time antecedent to that involved in the private action. It was

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the plaintiff complains, to deprive him of pictures except after an unreasonable period of delay, is said to have originated in the fall of 1955. Consequently, it is not the same conspiracy as that found to exist in the Paramount case. It should be emphasized that under the above quoted statute the decree is prima facie evidence only of a conspiracy covering the same area and existing during the same time as that involved in the case on trial."

[47] *Shotkin* v. *General Elec. Co.*, 171 F. 2d 236, 238 (10th Cir. 1948).

[48] 201 F. 2d 306 (4th Cir. 1953), aff'd, 346 U. S. 537 (1954).

[49] 334 U. S. 131 (1948).

merely a holding that plaintiff had no grounds to complain of the action of the trial court. It appears that the Supreme Court would have held the decrees to have been improperly admitted, if resolution of that question has been necessary to its decision. Otherwise, it would not have said: "Indeed, the relevancy of *Paramount* to the instant case is slight."[50]

Where the evidence shows that the business practices condemned in the prior government action have been changed, modified or abandoned, or that different business practices are questioned in the private action, it is difficult to see how the prior adjudication can be relevant to the private action. Introduction in evidence of a prior decree in such a case would seem to be prejudicial error.

Another variation is presented where the damage period entirely postdates the period adjudicated in the government action, but the plaintiff alleges that the conspiracy found in the government action has continued.[51] There have been several different approaches to this factual problem;[52] it is be-

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[50] "The trial judge instructed, in effect, that the *Paramount* decrees alone could not support a recovery by petitioner; additional evidence was required to relate the presumed *Paramount* conspiracy to Baltimore and to the claimed damage period. . . . The *Paramount* case involved a conspiracy found to exist as of 1945, which was enjoined no later than June 25, 1948; but the conspiracy alleged here involves a claimed damage period running from February 1949 to March 1950. Indeed, the relevancy of *Paramount* to the instant case is slight. We need not pass on respondents' contention that petitioner was entitled to no benefit at all from the earlier decrees. We merely hold that petitioner was entitled to no greater benefit than the trial judge gave it." 346 U. S. at 543-44.

[51] Allegations are not proof and it is a familiar practice to use descriptive terms and attempt to pour the facts of a case into the mould of decided cases. "But the mere reference to defendants' business activities by those descriptive terms, of course, does not demonstrate that they were the same as those condemned or different from those approved in the decided cases." *G. & P. Amusement Co.* v. *Regent Theater Co.*, 107 F. Supp. 453, 456 (N. D. Ohio 1952), aff'd *per curiam*, 216 F. 2d 749 (6th Cir. 1954).

[52] The problem is critical only in jury cases and holdings in non-jury cases are not of great weight. *Fifth & Walnut, Inc.* v. *Loew's, Inc.*, 176 F. 2d 587, 594 (2d Cir.), cert. denied, 338 U. S. 894 (1949). For example, in *Basle Theatres, Inc.* v. *Warner Bros. Pictures Distrib. Corp.*, 168 F. Supp. 553 (W. D. Pa. 1958), plaintiff's theater opened in 1954 but the conspiracy was claimed to have originated in the early 1930's. Judge McIlvaine said: "Portions of the Paramount decree were admitted into evidence. At the most they were only admissible under the limiting factors set down in

lieved, however, that exclusion of the decree is the soundest resolution. If the plaintiff has independent evidence of conspiratorial action continuing into the damage period, it does not need the decree which creates an estoppel as to a prior period. On the other hand, if there is no independent evidence of conspiratorial action in the damage period, the decree cannot supply the lacking evidentiary foundation for the action.[53] It is submitted that where the time period involved in the private action is subsequent to that in the government litigation there can be no estoppel relevant in the private action. Permitting a prior decree to be introduced in evidence in such a situation is alien to the principles of collateral decree in this type of factual setting: (1) the passage of time tion which it was never intended to cover.

Other factors dictate the complete exclusion of the prior estoppel and extends the basic concept of section 5 to a situausually creates a change in conditions which makes the admission of the prior decree improper;[54] (2) there is no presumption that any unlawful action continued after it was enjoined,[55] while there is strong support for the proposition that, presumptively, the prior decree was obeyed;[56] and, (3) the

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Theatre Enterprises v. Paramount Film Distributing Corp., . . . [346 U. S. 537 (1954)] and only as relating to the business practices of the relevant defendants prior to 1945. My opinion in the case would be the same if they had been refused." *Id.* at 559.

[53] *Monticello Tobacco Co.* v. *American Tobacco Co.*, 197 F. 2d 629, 631 (2d Cir.), cert. denied, 344 U. S. 875 (1952): "[W]hatever is crucial to the treble-damage case and is not distinctly determined in the previous government suit must be proven by direct evidence." In *B. & B. Theatres Corp.* v. *Atlanta Enterprises*, Civil No. 5300, N. D. Ga., March 16, 1959, the decrees from the "Paramount Case" relating to the period of 1945 and prior thereto, were held by Judge Sloan to be inadmissible in a private treble damage action seeking damages for the period 1951-1955.

[54] See *Shotkin* v. *General Elec. Co.*, 171 F. 2d 236, 238 (10th Cir. 1948); *City of Shreveport* v. *Shreveport Ry.*, 38 F. 2d 945, 946 (5th Cir.), cert. denied, 281 U. S. 763 (1930).

[55] *United States* v. *Hosteen Tse-Kesi*, 191 F. 2d 518, 520 (10th Cir. 1951); *Athens Roller Mills, Inc.* v. *Commissioner*, 136 F. 2d 125, 128 (6th Cir. 1943).

[56] Mr. Justice Reed, concurring, in *Timken Roller Bearing Co.* v. *United States*, 341 U. S. 593, 604 (1951), said: "An injunction was entered by the District Court to prohibit the continuation of the objectionable contracts. Violation of that injunction would threaten the appellant and its officers with civil and criminal contempt. . . .

(Footnote continued on page 455)

decree could, at most, be only of slight evidentiary value,[57] while its high prejudicial potentiality could result in an unfair trial.[58]

In contrast to the total exclusion approach, some courts have ruled that the decree cannot be introduced until the other evidence has shown that the practices condemned in the prior government action have continued into the damage period.[59] It seems that where such a ruling has been made the trial judge must make the preliminary ruling, and it would appear only fair that the court require clear and convincing proof. Certainly, the mere allegations of the complaint are not sufficient. As the time gap widens between the period adjudicated in the government case and the damage period, the stronger become the reasons for total exclusion.

Of course, decrees entered in a government action are not admissible against a defendant who was not a defendant in

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(Footnote continued from page 454)
The paucity of cases dealing with contempt of Sherman Act injunctions is, I think, an indication of how carefully the decrees are obeyed." See *Bigelow* v. *RKO Radio Pictures, Inc.*, 205 F. 2d 231, 233 (7th Cir. 1953).

[57] *Theatre Enterprises, Inc.* v. *Paramount Film Distrib. Corp.*, 346 U. S. 537, 544 (1954).

[58] In *Loew's, Inc.* v. *Cole*, 185 F. 2d 641, 661 (9th Cir. 1950), cert. denied, 340 U. S. 954 (1951), the court, quoting Wigmore, said: "'[I]f certain evidential material, having a legitimate probative value, tends nevertheless to produce also, over and above its legitimate effect, an unfair prejudice to the opponent, . . . there is good ground for excluding such evidence, unless it is indispensable for its legitimate purpose.' Wigmore on Evidence, Third Ed., §1864."

[59] In *Greene* v. *Lam Amusement Co.*, Civil No. 5287, N. D. Ga., March 3, 1959, Judge Sloan entered a pre-trial order on May 28, 1957, which limited the proof to the damage period, August 11, 1951 to August 11, 1955, and which provided: "Should the plaintiff offer proof that would justify the jury in finding that the antitrust laws have been violated by the defendants within this period, then, and in that event, the plaintiff will be allowed to show if he can that such conduct of the defendants is in furtherance of a previous understanding or conspiracy and the period of proof will then be extended so as to include but not go beyond the findings and decrees in the 'Paramount case.' . . . Upon the introduction of evidence from which the jury could find that the practices complained of here and which were condemned in the 'Paramount' decrees were continued to and were practiced by the defendants during the damage period here involved and that these illegal practices had an injurious effect upon plaintiff, his business or property, then, and in that event, the plaintiff will be permitted to introduce into evidence the final decrees in the 'Paramount case.'"

the government action.[60] The identity or lack of identity of parties to the two actions may be very important in deciding whether the conspiracies or violations of law charged in the two actions are the same or different. The Second Circuit has relied upon the differences in parties to the two actions in holding a prior government action inadmissible in the private action.[61] The Tenth Circuit reversed a jury verdict for plaintiff because the prior government decree was improperly admitted in an action involving differences in the parties defendant and differences in the time periods of the two actions.[62]

The lack of identity of parties may well be sufficient, in and of itself, to establish that the requirements of section 5 have not been met. Further, where some of the defendants in the private action were parties to the government suit and some were not, a situation is presented where admission of the decree, even with instructions limiting it to defendants who were in the government suit, may be reversible error. As a practical matter, no instruction can cure the prejudice done to those defendants against whom the decrees are inadmissible. In such case it may well be that they should be entitled to a new trial free from the prejudicial evidence.[63]

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60 *Paramount Film Distrib. Corp.* v. *Village Theatre, Inc.*, 228 F. 2d 721, 726-27 (10th Cir. 1955); *Sun Theatre Corp.* v. *RKO Radio Pictures, Inc.*, 213 F. 2d 284, 292 (7th Cir. 1954); *Momand* v. *Universal Film Exchs., Inc.*, 172 F. 2d 37, 48 (1st Cir. 1948), cert. denied, 336 U. S. 967 (1949); *Court DeGraw Theatre, Inc.* v. *Loew's, Inc.*, 172 F. Supp. 198, 200 (E. D. N. Y. 1959); *Samuel Goldwyn Prods., Inc.* v. *Fox West Coast Theatres Corp.*, 146 F. Supp. 905 (N. D. Cal. 1956); *Christensen* v. *Paramount Pictures, Inc.*, 95 F. Supp. 446, 455 (D. Utah 1950).

61 *Dipson Theatres, Inc.* v. *Buffalo Theatres, Inc.*, 190 F. 2d 951, 958 (2d Cir. 1951), cert. denied, 342 U. S. 926 (1952): "The fact that plaintiff now concedes that Columbia and Universal were not parties to the present conspiracy and concededly Shea and McFaul were not parties to the original Paramount action also indicates that that case is not controlling here."

62 *Paramount Film Distrib. Corp.* v. *Village Theatre, Inc.*, 228 F. 2d 721, 726-27 (10th Cir. 1955).

63 "The naive assumption that prejudicial effects can be overcome by instructions to the jury . . . all practicing lawyers know to be unmitigated fiction." *Krulewitch* v. *United States*, 336 U. S. 440, 453 (1949) (concurring opinion).

Where the findings in the government case rest upon evidence from a particularized area or locale, it would seem clear that no estoppel would be raised with respect to a different area. However, many government actions are basically economic surveys of general practices in an industry. In such instances the findings may rest on broad grounds without any adjudication of specific violations of law in a particular area. That was the situation in *United States* v. *Paramount Pictures, Inc.*[64] Not only did the findings not rest on evidence of violations of law in particular areas, but the court specifically disclaimed making any decisions as to local areas.[65] This type of situation has bred untold litigation and judges have spent countless hours attempting to resolve the problems created. Needless to say, the resulting decisions have not been uniform. The prevailing view[66] seems to have been to follow the lead of the trial judge in *Theatre Enterprises* v. *Paramount Film Distributing Corp.* The charge to the jury there was summarized by the Supreme Court:

> The trial judge instructed, in effect, that the *Paramount* decrees alone could not support a recovery by petitioner; additional evidence was required to relate the presumed

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[64] 66 F. Supp. 323, 70 F. Supp. 53 (S. D. N. Y. 1946), aff'd in part, rev'd in part, and remanded, 334 U. S. 131 (1948); 85 F. Supp. 881 (S. D. N. Y. 1949), aff'd mem. sub nom. *United States* v. *Loew's, Inc.*, 339 U. S. 974 (1950).

[65] "[T]he decision of such controversies as may arise over clearance should be left to local suits in the area concerned. . . ." 66 F. Supp. at 342.

[66] *Loew's, Inc.* v. *Cinema Amusements, Inc.*, 210 F. 2d 86 (10th Cir.), cert. denied, 347 U. S. 976 (1954); *Tivoli Realty, Inc.* v. *Paramount Pictures, Inc.*, 209 F. 2d 41 (5th Cir. 1954); *Twentieth Century-Fox Film Corp.* v. *Brookside Theatre Corp.*, 194 F. 2d 846 (8th Cir.), cert. denied, 343 U. S. 942 (1952); *Sablosky* v. *Paramount Film Distrib. Corp.*, 137 F. Supp. 929 (E. D. Pa. 1955); *Don George, Inc.* v. *Paramount Pictures, Inc.*, 111 F. Supp. 458 (W. D. La. 1951); *Webster Rosewood Corp.* v. *Schine Chain Theatres, Inc.*, 157 F. Supp. 251, 255 (N. D. N. Y. 1957) (dictum), aff'd, 263 F. 2d 533 (2d Cir.), cert. denied, 360 U. S. 912 (1959); *De Luxe Theatre Corp.* v. *Balaban & Katz Corp.*, 95 F. Supp. 983, 986 (N. D. Ill. 1951) (dictum). See *Harrison* v. *Paramount Pictures, Inc.*, 115 F. Supp. 312, 315 (E. D. Pa. 1953), aff'd *per curiam*, 211 F. 2d 405 (3d Cir.), cert. denied, 348 U. S. 828 (1954); *Homewood Theatre, Inc.* v. *Loew's, Inc.*, 110 F. Supp. 398, 407, 409 (D. Minn. 1952). Cf. *Sun Theatre Corp.* v. *RKO Radio Pictures, Inc.*, 213 F. 2d 284 (7th Cir. 1954); *Dipson Theatres* v. *Buffalo Theatres, Inc.*, 190 F. 2d 951, 957-58 (2d Cir. 1951), cert. denied, 342 U. S. 926 (1952).

> *Paramount* conspiracy to Baltimore and to the claimed damage period. The reasons for this are clear. The *Paramount* decrees did not rest on findings, nor were the findings based on evidence, of a particular conspiracy concerning restrictions on runs and clearances in Baltimore theatres; yet such a conspiracy is the nub of plaintiff's claim.[67]

Some courts have held that before the decrees may be admitted, plaintiff must prove by other evidence that the conspiracy related to the locality involved in the private action during the claimed damage period.[68]

If the government case relates to one product, it cannot be held to be an estoppel with reference to marketing practices of another product. Where, however, the products are in the same general class the problem is relatively easy. One court said:

> In view of the prima facie effect of the prior antitrust decree, all that plaintiff was required to do, as far as proving restraint is concerned, was to show that the general restraint applicable to waxes and polishes referred to in the prior decree was actually applied to the Karseal product, "Wax Seal."[69]

Identity of issues is also an important test in determining whether the prior government action contains an adjudication which may be admitted in the private treble damage action. The estoppel extends only to matters distinctly put in issue and directly determined in the government action. If the government case did not directly determine an issue involved in the later private action, there can be no estoppel as to a

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67 346 U. S. 537, 543 (1954).

68 *Loew's, Inc.* v. *Cinema Amusements, Inc.*, 210 F. 2d 86 (10th Cir.), cert. denied, 347 U. S. 976 (1954); *Sablosky* v. *Paramount Film Distrib. Corp.*, 137 F. Supp. 929, 935 (E. D. Pa. 1955).

69 *Richfield Oil Corp.* v. *Karseal Corp.*, 271 F. 2d 709, 713 (9th Cir. 1959).

material matter relevant in the private action.[70] The test of relevancy should be strictly applied. There must not be permitted a haphazard use of the prior decree or criminal judgment "merely for its aura of guilt, or 'to imply new wrongdoing from past wrongdoing.' "[71] This is particularly important, since the judgment or decree is not admissible to prove prima facie violations of law which did not injure the plaintiff in the private action.[72] Prior judgments and decrees are admissible only if they meet the tests of estoppel. They are not admissible on the "bad man" theory to arouse in each juror the "deep tendency of human nature to punish, not because our victim is guilty this time, but because he is a bad man and may as well be condemned now that he is caught."[73]

There is also a strong line of authority for the proposition that a judgment or decree from a prior government action cannot be used in a later private action where the facts sought to be prima facie proven by the judgment or decree are merely mediate facts and not the ultimate facts. Since the ultimate fact in the second action is that the defendants' conspiracy injured plaintiff's business or property, unless the proof shows that it was precisely the same conspiracy as that found in the government action, proof of the conspiracy found in the government action is merely a mediate fact.

In cases relating to the general doctrine of estoppel, the Supreme Court has required that the matter litigated in the prior action be "determinative of the matter in controversy in the second suit."[74] In other words, the doctrine of estoppel

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70 *Hillside Amusement Co.* v. *Warner Bros. Pictures, Inc.*, 224 F. 2d 629 (2d Cir. 1955) *(per curiam).*

71 *Monticello Tobacco Co.* v. *American Tobacco Co.*, 197 F. 2d 629, 632 (2d Cir.), cert. denied, 344 U. S. 875 (1952).

72 See notes 10-17 *supra* and accompanying text.

73 1 Wigmore, Evidence §57, at 456 (3d ed. 1940).

74 *United Shoe Mach. Corp.* v. *United States*, 258 U. S. 451, 459 (1922). In *New Orleans* v. *Citizens' Bank*, 167 U. S. 371, 396 (1897), an estoppel was said to exist "when the question upon which the recovery of the second demand depends has under identical circumstances and conditions been previously concluded by a judgment be-

is inapplicable where the matter litigated in the prior action is an evidentiary fact in the second suit. Judge Learned Hand has given a clear exposition of this aspect of the doctrine of estoppel:

> It is of course well-settled law that a fact, once decided in an earlier suit, is conclusively established between the parties in any later suit, provided it was necessary to the result in the first suit. . . . However, a "fact" may be of two kinds. It may be one of those facts, upon whose combined occurrence the law raises the duty, or the right, in question; or it may be a fact, from whose existence may be rationally inferred the existence of one of the facts upon whose combined occurrence the law raises the duty, or the right. The first kind of fact we shall for convenience call an "ultimate" fact; the second, a "mediate datum." "Ultimate" facts are those which the law makes the occasion for imposing its sanctions.[75]

After so classifying the facts, the court held that the prior adjudication was not an estoppel between the parties in the second action, since the fact established in the first suit was not an ultimate fact in the second action.[76] This so-called *Evergreens* doctrine was adopted in the 1948 Supplement to the *Restatement of the Law of Judgments.*[77]

This aspect of the doctrine of estoppel was carefully considered by the Supreme Court in the *Yates* case.[78] A defendant there argued that the favorable determination of a prior government suit was conclusive in the present proceeding or that it should have been given at least partially

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tween the parties. . . ." In *United States* v. *Moser*, 266 U. S. 236, 241 (1924), the test of estoppel by judgment was said to depend upon "whether the point or question presented for determination in the subsequent action is the same as that litigated and determined in the original action."

75 *The Evergreens* v. *Nunan*, 141 F. 2d 927, 928 (2d Cir.), cert. denied, 323 U. S. 720 (1944).

76 *Id.* at 930-31.

77 Restatement, Judgments §68, comment p (Supp. 1948).

78 *Yates* v. *United States*, 354 U. S. 298 (1957).

conclusive effect in the instruction to the jury. The Supreme Court rejected these contentions, saying: "The normal rule is that a prior judgment need be given no conclusive effect at all unless it establishes one of the ultimate facts in issue in the subsequent proceedings. So far as merely evidentiary or 'mediate' facts are concerned, the doctrine of collateral estoppel is inoperative." [79]

Before this emphatic espousal in 1957 of the *Evergreens* doctrine, there may have been some reason for refusing to apply this established principle of estoppel in a section 5 case.[80] Now, however, the Supreme Court has dispelled any lingering doubts. The application of the *Evergreens* doctrine would limit section 5 to those cases where the private plaintiff was injured by the *same conspiracy* as that adjudicated in the government case. This was precisely the situation to which Congress intended section 5 to apply. Judge Nordbye, paraphrasing the purpose of that statute, has said:

> In effect, Congress said to the law violator, "It is to your advantage to capitulate to our demands before any testimony is taken in any equity or criminal proceedings. If you fail, and a decree or judgment is entered against you, such decree or judgment will constitute prima facie proof to any or all private litigants who may have been injured by your unfair practices." [81]

Even if the court makes the basic determination that the prior decree is admissible, several problems still remain as to its use. These include: (1) reference in opening statements to the government action; (2) the documents to be admitted; and, (3) the instruction to be given to the jury.

It is readily apparent that permitting plaintiff's counsel to refer to the government action in the opening statement may be extremely prejudicial. If the judgment or decree is

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79 *Id.* at 338.

80 Compare *Zuckerman* v. *E. I. duPont de Nemours & Co.*, 1955 Trade Cas. ¶68,022 (S. D. N. Y.).

81 *Twin Ports Oil Co.* v. *Pure Oil Co.*, 26 F. Supp. 366, 376 (D. Minn. 1939).

actually admitted into evidence, no reversible error has been committed. On the other hand, if the judgment or decree is held to be inadmissible, an instruction to the jury to disregard the mention of the government action might serve further to prejudice the defendants. The fairest handling of the problem has been to prohibit any mention of the prior action until the court has decided the question of admissibility.[82] Other judges have, however, permitted brief mention of the prior case in the opening statement.[83] Apparently, the matter has not been tested in an appellate court.

Determination of which document or documents are actually admissible has caused problems. The statute refers only to judgments or decrees. It makes no mention of indictments, complaints, findings of fact, conclusions of law or opinions. It would certainly seem that if the trial court explains the scope of the estoppel there would be no reason to introduce anything other than the judgment or decree. However, the Supreme Court, in *Emich Motors Corp.* v. *General Motors Corp.*, said: "A similar discretion must be exercised in approving the attachment of a copy of the indictment as an exhibit to the complaint."[84] Apparently following this hint, some courts have permitted the introduction in evidence of equity petitions, final decrees, findings of fact, conclusions of law

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[82] In *T. C. Theatre Corp.* v. *Warner Bros. Pictures, Inc.*, Civil No. 75-213, S. D. N. Y., May 5, 1955, Judge McGohey said: "I want no reference made to the decree in the opening statements by anybody, and I want no attempt to offer the decree made in the presence of the jury.

"When you come to the point where you think your record is such that that is where in your view of the orderly proof the decree ought to come in, I want you to let me know out of the hearing of the jury that you propose to do it, and then the state of the record may be so clear that we would have no difficulty in agreeing on it, or it may be so clear that I will have no difficulty in saying no, you can't put it in at this time.

"But if there is an area of doubt about it, we can discuss it out of the presence of the jury." Record, vol. 2-147, p. 82, *ibid.* Accord, *Wolfe* v. *National Lead Co.*, 15 F. R. D. 61, 63 (N. D. Cal. 1953).

[83] Record, vol. 1, p. 54, *Victoria Amusement Corp.* v. *Warner Bros. Circuit Management Corp.*, Civil No. 50-578, D. Mass., Nov. 22, 1954.

[84] 340 U. S. 558, 572 (1951).

and even a bill of particulars.[85] This would appear to be an unsound practice, since the scope of the estoppel is a question of law for the judge and the introduction of findings, etc., makes the matter one of fact which the jury may decide.[86]

It must always be borne in mind that the purpose of introducing the prior decree is to offer prima facie evidence of conduct of the defendants at a time prior to the entry of the judgment or decree in the government action. It is totally irrelevant to show what the defendants did thereafter, and a private cause of action for damages may not be founded on a violation of a decree.[87] It is "clear that Congress did not intend that the efforts of a private litigant should supersede the duties of the Department of Justice in policing an industry." [88] A private plaintiff has no cause to complain of a conspiracy affecting the general public, without proof of special damage.[89]

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[85] *Twentieth Century-Fox Film Corp.* v. *Brookside Theatre Corp.*, 194 F. 2d 846, 853-54 (8th Cir.), cert. denied, 343 U. S. 942 (1952). But see *Sullivan* v. *Associated Billposters & Distribs. of United States*, 272 Fed. 323, 328 (S. D. N. Y. 1919).

[86] Findings of fact and conclusions of law are not part of a judgment. *In re D'Arcy*, 142 F. 2d 313, 315 (3d Cir. 1944); *Baxter* v. *City & County of Dallas Levee Improvement Dist.*, 131 F. 2d 434 (5th Cir. 1942); *Winkleman* v. *General Motors Corp.*, 48 F. Supp. 490, 494 (S. D. N. Y. 1942).

[87] "Whether defendants have violated said [Paramount] decree is not a matter which this Court can consider." Order of Oct. 21, 1952, *Ritz Theatre Corp.* v. *Twentieth Century-Fox Film Corp.*, Civil No. 7438, W. D. Mo., June 18, 1953. Accord, *Tivoli Realty, Inc.* v. *Paramount Pictures, Inc.*, 80 F. Supp. 800, 805 (D. Del. 1948). Cf. *T. C. Theatre Corp.* v. *Warner Bros. Pictures, Inc.*, 16 F. R. D. 173 (S. D. N. Y. 1954) (plaintiff could not bring findings of facts in government decree up to date); *United States* v. *Paramount Pictures, Inc.*, 75 F. Supp. 1002 (S. D. N. Y.), aff'd in part, rev'd in part, and remanded on other grounds, 334 U. S. 131 (1948) (stranger could not put defendants in contempt for violating government decree).

[88] *United States* v. *Borden Co.*, 347 U. S. 514, 519 (1954). Accord, *Goldlawr, Inc.* v. *Shubert*, 169 F. Supp. 677, 691 (E. D. Pa. 1958); *Slick Airways, Inc.* v. *American Airlines, Inc.*, 15 F. R. D. 175, 178 (D. N. J. 1954); *Ronson Patents Corp.* v. *Sparklets Devices, Inc.*, 112 F. Supp. 676, 686 (E. D. Mo.), aff'd, 202 F. 2d 87 (8th Cir. 1953); *Zenith Radio Corp.* v. *Radio Corp. of America*, 106 F. Supp. 561, 576 (D. Del. 1952).

[89] *Monticello Tobacco Co.* v. *American Tobacco Co.*, 197 F. 2d 629, 631 (2d Cir.), cert. denied, 344 U. S. 875 (1952); *Brownlee* v. *Malco Theatres, Inc.*, 99 F. Supp. 312 (W. D. Ark. 1951).

In regard to the problem of instructions, most courts have given the jury a preliminary instruction when the prior decree is admitted and have also given a full instruction in the charge. There is a wide discretion in such matters.

There remain many intriguing problems which may arise under Section 5 of the Clayton Act. The widely differing factual circumstances presented in each case and the fact that many of the questions herein discussed have not been passed upon by appellate courts make this aspect of the antitrust laws one which, it can reasonably be predicted, will continue to be a battleground in the future.

A RAILROAD MERGER—DISSECTED*

by

Henry P. Riordan

New York City

The proposed merger of the New York Central and Pennsylvania railroads into the largest railroad transportation system in the nation is the latest in an ever-increasing surge toward railroad unification. Following the merger of the Norfolk & Western and Virginian Railroad in 1959 came the consummation of the unifications of the Erie and Lackawanna Railroads, the Soo Line-Wisconsin Central-Duluth, South Shore & Atlantic Railroads and the C&NW and the Minneapolis & St. Louis. Among other proposed unifications in various stages of development are the merger of the Atlantic Coast Line and Seaboard Airline, the Norfolk & Western-Nickel Plate-Wabash consolidation, the Great Northern-Northern Pacific-Chicago, Burlington & Quincy consolidation, the C&O-B&O unification, the acquisition of control of the Western Pacific sought by both the Santa Fe and the Southern Pacific and the acquisition of control of the C&EI by both the Illinois Central and the Missouri Pacific.

One of the principal reasons for the present outbreak of railroad mergers has been the realization by the railroads, the public and the Interstate Commerce Commission that railroad unifications are one of the most important areas where major economies can be realized in order to offset declining revenues and higher operating expenses.

The present statutory authority—although not perfect—is certainly sufficient to permit railroad unifications without

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the incurrence by the merging partners of any insurmountable problems. Such, of course, was not always the case. Under the original Transportation Act of 1920, the Interstate Commerce Commission was directed to prepare a plan for the consolidation of the country's railroads into a limited number of systems, such plan to preserve competition as fully as possible and wherever practicable to maintain the existing routes and channels of commerce. Although the Act permitted control by one railroad over another either by lease or purchase of stock if authorized by the Commission, actual consolidations into a single system for ownership and operation were permitted only if in harmony with the master plan to be prepared by the Commission.

Professor William Z. Ripley of Harvard University, one of the leading railroad authorities of the day, was retained by the Commission to prepare a plan of consolidation. In 1921, Professor Ripley recommended a plan to the Commission and the Commission adopted a tentative modified version of the plan proposed. After lengthy hearings the Commission published a final plan in 1929 which visualized the consolidation of the nation's railroads into a number of systems. As a basis for comparison with present-day unification plans, there is set forth below the various systems proposed by the Commission and the principal railroads included in each:[1]

1. Boston & Maine-Bangor & Aroostook-Maine Central
2. New Haven-New York & Ontario
3. New York Central-DL&W-Virginian
4. Pennsylvania-DT&I-Long Island-Norfolk & Western-Wabash
5. B&O-Ann Arbor-Reading-Western Maryland
6. C&O-Erie-Lehigh Valley-Nickel Plate-Susquehanna-Pere Marquette-C&EI

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[1] As adjusted to reflect certain revisions made by the Commission through 1939.

7. Seaboard Air Line
8. Atlantic Coast Line-L&N
9. Southern-Norfolk Southern-Florida East Coast
10. Illinois Central-Central of Georgia
11. C&NW-Chicago, St. Paul, Minneapolis & Omaha-GM&O
12. Great Northern-Northern Pacific
13. Chicago, Milwaukee, St. Paul & Pacific
14. Burlington-MKT-Great Western (½)
15. Union Pacific-Great Western (½)
16. Southern Pacific-Texas & New Orleans
17. Santa Fe-Chicago Great Western
18. Mopac-Texas & Pacific-Western Pacific
19. Rock Island-Frisco-Kansas City Southern
20. Canadian National
21. Canadian Pacific-Soo

The master consolidation plan, however, did not provide a solution since railroad management apparently was not interested in this kind of master planning which would require the assimilation of weak railroads into strong railroads, and Congress did not give to the Commission, and the Commission did not seem to desire, any mandatory powers to require a regional consolidation of the nation's railroads. Commencing in 1925, the Commission periodically recommended to Congress that it be relieved of its obligation to formulate a final plan. Finally in 1940, the Act was amended to eliminate the requirement that the Commission prepare a master plan and that railroad unifications be in accordance therewith.[3] This

[3] In a recent report on National Transportation Policy prepared for the Senate Committee on Interstate and Foreign Commerce, a study group headed by John

also had the effect of eliminating the requirement that competition be preserved in railroad unifications. The elimination of the preservation of competition was an important step forward, particularly in view of the railroads' present plight and the increasing competition by other means of transportation, particularly trucks, buses and airplanes. It will be remembered that in 1926 the application of the Norfolk & Western to control the Virginian through a lease arrangement was rejected by the Commission principally on the basis that competition would not be preserved.

Mergers of railroad companies, like mergers of other companies, are subject to the strictures of the antitrust laws. In fact, it was a merger of railroad companies that was held to be a violation of the Sherman Act before the enactment of the Clayton Act. *Northern Securities Co.* v. *U. S.,* 193 U. S. 197 (1904). There are certain exemptions from the antitrust laws, however, which may apply to a proposed merger of railroad companies.[8] First, Section 7 of the Clayton Act, by its own terms, exempts certain carrier transactions:

> "Nor shall anything herein contained be construed to prohibit any common carrier subject to the laws to regulate commerce from aiding in the construction of branches or short lines so located as to become feeders to the main line of the company so aiding in such construction or from acquiring or owning all or any part of the stock of such branch lines, nor to prevent any such common carrier from acquiring and owning all or any part of the stock of a branch or short line constructed by an independent company where there is no substantial competition between the company owning the branch line so constructed and the company owning the main line ac-

P. Doyle has recommended that there be a new attempt made to provide for railroad consolidations on a national or regional basis.

[8] See Stevens, *The Regulation of Railroads*, in Symposium on Antitrust and the Regulated and Exempt Industries, 19 A. B. A. Antitrust Section 355 (1961); Korbel, "The Interstate Commerce Commission and Monopoly," 29 *I. C. C. Prac. J.* 318 (1961).

quiring the property or an interest therein, nor to prevent such common carrier from extending any of its lines through the medium of the acquisition of stock or otherwise of any other common carrier where there is no substantial competition between the company extending its lines and the company whose stock, property, or an interest therein is so acquired."

In addition, Section 5(2) of the Interstate Commerce Act provides that it shall be lawful, with the approval and authorization of the ICC,

> " . . . for two or more carriers to consolidate or merge their properties or franchises, or any part thereof, into one corporation or for any carrier, or two or more carriers jointly, to acquire control of another through ownership of its stock or otherwise . . . "

Section 5(11) of the Interstate Commerce Act provides that the power conferred by that Section is "exclusive and plenary" and that

> " . . . any carriers or other corporations, and their officers and employees and any other persons, participating in a transaction approved or authorized under the provisions of this section shall be and they are relieved from the operation of the antitrust laws and of all other restraints, limitations, and prohibitions of law, Federal, State, or municipal, insofar as may be necessary to enable them to carry into effect the transaction so approved or provided for in accordance with the terms and conditions, if any, imposed by the Commission, and to hold, maintain, and operate any properties and exercise any control or franchises acquired through such transaction. . . . "

In order to provide an outline of the numerous steps involved in unification and to give the reader some idea of the timing of the various steps, there is set forth below a timetable of the principal steps involved in the Erie-Lackawanna merger. It should be mentioned that, in view of the fact that

three-way unification talks had been going on since 1957 between the Delaware & Hudson, the Erie and the Lackawanna, a great deal of ground work for the subsequent two-way merger of the Erie and the Lackawanna had been laid by the time it was found impractical for the Delaware & Hudson to be included in a unification plan.

Erie-Lackawanna Merger Timetable

Commencement of two-way merger discussions	About April, 1959
Board of Directors meeting to approve merger terms and forms of supplemental indentures	June 24, 1959
Informal submission of drafts of merger agreement to offices of Secretaries of States for approval	June 24, 1959
Filing of application for Federal tax ruling	June 25, 1959
Informal meeting with large insurance company bondholders	June 25, 1959
Execution of merger agreement	June 24-July 1, 1959
Filing of ICC application	July 1, 1959
Informal submission of drafts of proxy material to SEC and Stock Exchange	July 8-17, 1959
Formal filing of proxy material with SEC	July 20-23, 1959
Receipt of Federal tax ruling	July 27, 1959
Formal comments received from SEC on proxy material	July 30, 1959
Notices of bondholders meetings given and bondholders proxy material sent out	August 3, 1959
Record date for stockholders meetings	August 13, 1959
Notices of stockholders meetings and proxy material sent out	August 17, 1959
Stockholders meetings	September 22, 1959

ERIE-LACKAWANNA MERGER TIMETABLE (Cont.)

Bondholders meetings	September 22-Oct. 20, 1959
Commencement of ICC hearings	September 29, 1959
ICC examiner's report served	March 30, 1960
Date for filing exceptions to proposed report	April 29, 1960
Applicant's reply to exceptions	May 16, 1960
Report and order of ICC issued	September 13, 1960
Board meeting to accept ICC order and fix merger date	September 29, 1960
Effective date of merger	October 17, 1960
Meeting of unified Board to authorize supplemental indentures, elect officers, etc.	October 17, 1960

As can be seen from the foregoing timetable, the railroad merger route is not one which can be traveled at a high rate of speed. There are many reasons for the long time period which elapses between the commencement of discussions and the effectiveness of the unification, a number of which are discussed below.

DETERMINATION OF ECONOMIES

The most important reason which presently leads railroad management to commence merger discussions is, of course, the belief that substantial economies will be effected through unification. At the very beginning of the merger talks, a joint merger committee of the prospective merger partners should be set up to review thoroughly all phases of the operations of both railroads to see where and to what extent such economies can be made, *i.e.,* elimination of parallel lines, consolidation of maintenance facilities and freight yards and resulting savings in wages and other expenses. Consideration should also be given to the retention of independent consult-

ing engineers to make a thorough merger study in cooperation with the merger committee. The testimony of such consultants will usually smooth the path to a great extent in connection with the ICC hearings since the testimony of such consultants can form the nucleus of the testimony given at the hearing and should be given considerable weight—particularly since in most cases objecting railroads will not have independent evidence to offer in refutation.

Financial Terms

The financial terms of any merger, *i.e.*, the basis of the division of stock of the surviving railroad, are, of course, the responsibility of the executive and financial officers of the railroads contemplating unification. Frequently one or more investment banking houses are called in as experts. Although many financial considerations are explored before the financial terms can be agreed upon, the most important consideration is the earning power of the respective railroads. The conjectural nature of future earnings will require a historical comparison of past earnings in estimating prospective earning power. In making such a comparison it is necessary that the railroads agree on the particular years in respect of which the comparison is to be made, *i.e.*, the last five, ten or more years. After the period of years is agreed upon, allowance should be made for any unusual factors which materially affected the earnings of one—but not both—of the railroads in the period agreed upon, *i.e.*, floods, labor disturbances, etc.

In addition to the comparison of net earning power during the agreed period, an important consideration should also be the trend in earnings of each of the railroads in question. If the earnings trend of one of the railroads shows a more marked variation in recent years—either upwards or downwards—sufficient weight must be accorded to such trend in arriving at the merger terms since that would indicate, absent some unusual circumstances, the trend of the prospective earning power of the railroads concerned. This is particularly important in the railroad industry where freight traffic has

been declining in recent years at a rate of about 3% per annum.

Obviously, since the final result must be approved by stockholders, the relative treatment of the stocks of the merging railroads cannot vary too greatly from relative market values.

Review of Corporate History and Indentures

At the very inception of the merger talks it is essential that counsel make a complete review of the corporate history, contracts and indentures of the railroads contemplating unification.

A review of corporate history is important in a case where the railroad has been created by an act of the legislature and has, in the past, been a party to numerous mergers. Although it is true that the Interstate Commerce Commission has the power to override burdensome provisions which might otherwise interfere with the consummation of a merger on fair and reasonable terms, it is well that counsel apprise himself at an early stage of the nature of any such provisions rather than be taken by surprise at some future date when the merger is well along the road to consummation. Also, it is important for counsel to ascertain the particular state laws to be followed in connection with the required stockholders vote on the plan since Section 5(11) of the Interstate Commerce Act requires that the required state vote be obtained where one is specifically provided for. Otherwise, a vote of a majority of the voting stock is required by the Act. Where the railroad in question has not accepted the general corporation law of its state of incorporation, research will be required in order to determine the appropriate law to be followed.

An early review of the corporate mortgages and indentures of the railroads contemplating unification is of utmost importance, particularly where one or both of the railroads have outstanding debt obligations in respect of which interest and/or sinking funds are payable only out of available net income. In the case of the Erie-Lackawanna merger, the Erie

had three types of such obligations outstanding and the Lackawanna nine. Since the provisions as to the determination and application of income contained in the respective indentures of each of those railroads would have been in conflict after consummation of the merger, it was necessary to work out a fair formula pursuant to which a specified percentage of the unified company's available net income would be applied to satisfy the income obligations of each railroad. That percentage, as finally reflected in the amendments to each of the indentures having available net income provisions, bore a close relationship to the manner in which the stock of the unified company was to be divided since, again, the most important basis for such a division is the respective earning power of each of the railroads.

Counsel's review of the railroad indentures should also encompass the following considerations:

(1) Do the after-acquired property clauses in the mortgages of either of the railroads purport to cover the lines of railroad or the railroad equipment of the other railroad? If so, an appropriate amendment may be desirable in order to avoid the possibility of a conflict or a technical default after unification.

(2) Do any of the mortgages constitute an adequate vehicle for future financings? If not, it may prove desirable to provide for appropriate amendments so as to modernize the issue provisions of one or more of the mortgages.

(3) Are the release provisions adequate in order to give the unified company the necessary flexibility to abandon parallel lines or to effectuate any of the other savings which the unified company expects to make? If not, the release provisions should be appropriately amended. I am sure the reader will agree that it would be very embarrassing to counsel if the merger were effected and it should then turn out that the contemplated economies could not be made without again going back to the bond-

holders for an appropriate amendment to the release provisions.

(4) Does each of the mortgages permit a merger on reasonable terms?

(5) What requirements will have to be complied with in each of the mortgages to effectuate the desired amendments?

Bondholders and Stockholders Meetings

(a) *Preliminary Steps.* After the provisions of each of the mortgages have been thoroughly explored and tentative agreement reached between the railroads as to appropriate division of the net income between the indentures of the two railroads and as to the other amendments to be proposed to bondholders, it is wise for appropriate financial officers from each railroad to discuss the proposed changes with the principal security holders as early as possible since, without their cooperation, it is unlikely that the necessary vote will be obtained. After the major holders are approached, consideration should then be given to the holding of a wider informal meeting of the larger institutional investors at which the proposals can be discussed. Particular care should be given to the proxy rules in connection with these meetings in order to avoid any possibility of an inadvertent violation thereof. In determining the institutional investors with whom preliminary discussions are to be held, particular care should be taken not to offend any large holder by not including such holder in the preliminary discussions. One possible way to do that would be to limit the preliminary discussions solely to insurance companies on the theory that they have traditionally given more minute consideration to financing terms than other holders. Of course, if the acquiescence of a large non-insurance company holder is essential an exception should be made.

In the Erie-Lackawanna merger it was finally agreed that available net income of the unified company was to be apportioned 72% to the Erie bondholders and 28% to the Lacka-

wanna bondholders. The amendments provided for the application of such respective percentages to the payment of the income obligations of each of the respective railroads and, if after such application one railroad had a surplus and the other a deficit, the application of such surplus to the obligations of the other. One exception was made in that the Erie income debenture holders were not entitled to have any of the income applied to the income debentures unless the other income obligations of both roads were first satisfied in full since the income debentures were issued in exchange for preferred stock and by their terms were subordinate to all other income obligations—including those of a unified railroad in the event of a merger.

(b) *Preparation of Proxy Statement.* In setting a proposed timetable for the stockholders meetings and the various bondholders meetings, preliminary drafts of the proxy material should be submitted to the Securities and Exchange Commission well in advance of the required 10-day filing, particularly where extensive amendments are being made to the mortgages. In the case of the Lackawanna, the first drafts of the material were submitted to the Securities and Exchange Commission on July 8, 1959, and formal comments received on July 30, 1959. Where the material is free from complications there should be no reason why it cannot be processed with more expedition than in the case of the Erie-Lackawanna material. One question of a material nature which arose in connection with discussions with the SEC staff was whether the statement by the independent consultants that the merger would result in an annual saving of $13,000,000 per year within five years could properly be used in the proxy material. The initial position of the staff was that savings estimates were of such a conjectural nature as to prohibit their use in any definite terms in a proxy statement. Thus, a reference to "substantial savings" was also initially believed to be too conjectural, while the staff thought that the term "some savings" could be used. Since the whole basis of the merger, as in the case of most unifications, was the substantial savings to be

effected, it was believed that without any reference to the substantial nature of such savings, it was possible that the obtaining of the necessary affirmative vote of one or more of the issues might prove difficult. In discussing the question with the SEC staff, stress was laid on the fact that the omission from the proxy material of the conclusion of the consulting engineers on which the whole merger was based might itself be of such a material nature as to be a violation of the proxy rules. After considerable discussion, and after additional evidence was given to the SEC to the effect that the most important element in the savings estimate was savings in labor costs, the SEC agreed to the use of a definitive savings estimate in the proxy material. It is believed that this problem could be more readily disposed of in the future if, in filing the preliminary proxy material, counsel supported all references to savings estimates by supplementary information prepared by the consultants giving a breakdown of the various categories of savings and the amount of each. If independent consultants have not been retained to make a cost study, such information should be furnished by the representatives of the railroads making such a study.

The statement in the Lackawanna proxy statements that certain named large security holders had informally indicated to the Lackawanna that they intended to vote in favor of the amendments or the merger, as the case may be, is believed to have facilitated obtaining affirmative votes from smaller holders. Before including any such statement, however, counsel should clear the wording of the same with the named companies. Where, for example, the proposal has not as yet gone before the finance committee of an insurance company it might well be considered presumptuous of the railroad to include such a statement without prior clearance from a responsible officer of the company even though such officer had indicated in advance that affirmative action on the proposal would be recommended.

(c) *Solicitation.* If a particularly large affirmative vote is required or the voting power is greatly diffused, manage-

ment should consider the retention of a proxy-soliciting firm to aid it in obtaining the necessary vote. Although it was necessary to adjourn a few of the Lackawanna bondholders meetings because of the lack of a quorum, in the end the requisite vote was obtained. Without the help of a proxy-soliciting firm further delay might well have resulted. Where there are substantial numbers of unregistered bondholders, consideration should also be given to the inclusion of a clip-out coupon under the notices of the meetings published in the newspapers, which coupon the reader can mail to the railroad in order to obtain proxy material. Good results were obtained from the use of such device in the Lackawanna solicitations.

As far as the relative importance of the soliciting material, most holders, with the exception of large institutional investors, will pay more attention to the president's letter than to the remainder of the material and, for that reason, the use of such a letter, and possibly a follow-up letter, is in most cases advisable. Attention should be given to the drafting of the president's letter to make it as persuasive as possible, consistent, of course, with the proxy rules.

Where solicitation for several meetings is being made concurrently, counsel should consider the use of a different colored proxy for each meeting in order to facilitate the review and counting of proxies. Bondholders' proxies should be kept as simple as possible consistent with the requirements of the indenture—particularly as to the proof of ownership required from coupon bondholders—so as to eliminate to as great an extent as possible the necessity of returning proxies for correction.

Property Transfer Taxes

Great care should be exercised by counsel in the preparation of the merger documents to minimize the possibility of the incurrence of state or local property transfer taxes on the transfer of the property of the non-surviving railroad

to the surviving railroad. Such taxes can amount to a substantial sum in certain of the states. In the case of a Pennsylvania company, Pennsylvania counsel has advised that all references to the transfer of property in the merger agreement should be qualified to show that such transfer is being made by operation of law and not by the agreement. It is understood that the Pennsylvania tax officials have recently brought an action against a merged company for the collection of property transfer taxes in respect of property acquired on a merger.

ICC Hearings

Particularly where independent consulting engineers have been retained the merging partners should not have any great difficulty presenting their case to the hearing examiner in order to support the required findings. Section 5(2) of the Interstate Commerce Act requires a finding that the unification will be consistent with the public interest. In making such finding the Act requires the Commission to give weight to (1) the effect of the unification upon adequate transportation service to the public, (2) the effect upon the public interest of the inclusion of, or the failure to include, other railroads, (3) the fixed charges resulting from the unification, and (4) the interests of the carrier employees affected. Where, as in the East, there is a long history of declining earnings, the testimony of the consulting engineers as to the savings which will result from unification will go a long way in showing that the unification will benefit the transportation service to the public. The bolstering of the financial stability of the railroads in these days would seem certainly to have the concurrent effect of benefiting the transportation service to the public. Where the inclusion or exclusion of other roads is in question, the consulting engineers also can be expected to furnish the main part of the testimony. Fixed charges normally will not be a problem unless extensive financing is required in connection with the proposed unification. The

effect on carrier employees will be discussed later in this article.

The principal cause of delay in merging, over which the merger parties have little control, is the long period which elapses between the time the ICC application is filed and the date the final order issued—13½ months in the case of the Erie-Lackawanna. Since delay in effecting unification in most instances will be accompanied by a like delay in putting into effect substantial cost savings through unification—in the case of the Erie-Lackawanna, estimated at over $35,000 per day—every effort should be made to pare to the bone the administrative time lag. Approximately six months elapsed between the time of the hearings and the issuances of the preliminary report in the Erie-Lackawanna proceeding; four months elapsed between the filing of applicant's reply to the exceptions to the report and the issuance of the final order; and one month elapsed between the date of the final order and the date on which the merger was allowed to become effective.

The exceptions filed, and ensuing arguments, by connecting railroads, labor, local interests and minority stockholders are, of course, another cause of delay. The type of intervening arguments which other railroads, labor, and stockholders can be expected to advance, as well as proposed interventions by the Justice Department, are discussed below.

Railroad Intervention

The principal protection sought by intervening railroads (other than in cases where objection is being made to the unification as such) is normally the imposition of conditions by the Commission which, in effect, will protect their interline traffic from decreasing after the unification of the merging partners. Many shippers do not specify junction points in designating the routing of their freight—but merely name the railroads. Where one of the merging railroads (A Railroad) parallels in part the track of an intervening railroad, and both connect with the other merging railroad (B Rail-

road), when a shipper designates a shipment to go B Railroad-intervening railroad, the shipment would, prior to merger, be carried by intervening railroad from the point of connection with B Railroad. After merger, however, absent any conditions imposed by the Commission, the same shipment would in all probability be turned over to intervening railroad at the most distant point at which A Railroad connects with intervening railroad—thereby cutting down the length of the haul and intervening railroad's share in the revenues from the shipment.

The Commission has in recent years prescribed its so-called standard conditions for the protection of connecting railroads against unfair discrimination. In substance, those conditions are that the unified company maintain the prior open routes and channels of trade, continue the prior neutrality of handling traffic inbound and outbound without discrimination, continue prior operating arrangements with all connecting railroads and permit industries their full opportunity to select the routes and gateways over which to route their traffic. The position of some of the intervening railroads that additional specific limitations and conditions be imposed over and above the standard conditions has not met with favor by the Commission. In view of the delaying effect of extensive hearings and arguments in respect of the imposition of additional specific conditions over and above the standard conditions and in view of the fairly constant position of the Commission in rejecting additional limitations requested by intervening railroads, it would seem that only in the most unusual circumstances would intervening railroads be warranted in pressing arguments for conditions over and above the standard conditions.

Union Intervention

As a condition to the approval by the Interstate Commerce Commission of a merger, Section 5(2)(f) of the Act requires that the Commission order include conditions providing that, for a period of four years, the merger will not

result in the railroad employees being "in a worse position with respect to their employment". Since the enactment of the Transportation Act of 1940 the Commission has uniformly imposed compensatory conditions upon all applications approved under Section 5(2) which, in effect, provide for protection to railroad employees against financial losses which may result during the four-year period. Such conditions all refer back to the Washington Job Protection Agreement of 1936, which was signed by most of the major railroads and nearly all of the railroad brotherhoods. Those conditions were subsequently broadened and are now usually referred to as the "New Orleans" conditions. In view, however, of the numerous proposed unifications in the offering, and the fact that the Railroad Labor Executives Association estimates that proposed railroad unifications will have the effect of cutting down railroad employee jobs by 25%, the Association contended in the Erie-Lackawanna proceedings that the phrase "in a worse position with respect to their employment" requires that all employees be retained in an active employment status and that the compensatory provisions heretofore imposed by the Commission do not meet the requirements of the Act. The Association's position was rejected by the Supreme Court in *Brotherhood of Maintenance of Way Employees* v. *United States,* 366 U. S. 169 (1961). There, the Supreme Court affirmed the Commission's imposition of the compensatory "New Orleans" conditions in the Erie-Lackawanna case and held that Section 5(2)(f) did not require that employees of merging carriers be retained in their jobs.

In more recent proceedings, the Association has maintained that Section 5(2)(f) requires that protection be accorded by the merging carriers to employees of all railroads which might in some manner be affected by approval of the merger application, rather than limited solely to the affected employees of the applicant carriers. Thus, for example, the Association urged in the Seaboard Airline—Atlantic Coast Line case that employees of the Florida East Coast Railway, which asserts that it will be adversely affected by the pro-

posed merger, must be protected under Section 5(2)(f) as well as the employees of the merging carriers. This new position of the Association may eventually be tested in the courts.

Justice Department Intervention

Section 5(11) of the Interstate Commerce Act excludes a unification approved by the Commission from the operation of the antitrust laws. It is understood, however, that the Antitrust Division of the Justice Department has decided to intervene in the proceedings in respect of the proposed Atlantic Coast Line-Seaboard merger and the proposed B&O-C&O unification, and also in the Southern Pacific and Santa Fe proceedings over the control of the Western Pacific. An attorney from the Antitrust Division has stated that the purpose of such interventions is to stress any anti-competitive effects which might result from unification and any possible situation where depressed-areas communities, from which industry has moved, would be without rail service if the unification (and requested abandonments) was approved.

With respect to the proposed New York Central-Pennsylvania merger, Senator Kefauver has urged that the Justice Department give serious thought to taking a strong and active role in opposition to the merger right from the beginning, and that the ICC put off a decision on all major rail mergers until a national policy on such mergers could be recommended by a proposed commission representing industry, the Government and the public.

Under its present statutory authority, the ICC is not required to disapprove a merger of railroads which would otherwise violate Section 7 of the Clayton Act.[4] As the Supreme Court stated in *Minneapolis & St. Louis RR. Co.* v. *U. S.*, 361 U. S. 173, 186-8 (1959):

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[4] For a recent evaluation by a Member of the Commission of the factor of competition in assessing railroad mergers, *see* Tucker, "The Public Interest in Railroad Mergers," *I. C. C. Prac. J.* 342 (1961).

"Section 5(11) is both a more recent and a more specific expression of congressional policy than §1 of the Sherman Act and §7 of the Clayton Act, and in terms relieves the acquiring carrier, upon approval by the Commission of the acquisition, 'from the operation of the antitrust laws . . . ' Although §5(11) does not authorize the Commission to 'ignore' the antitrust laws, *McLean Trucking Co.* v. *United States,* 321 U. S. 67, 80, there can be 'little doubt that the Commission is not to measure proposals for [acquisitions] by the standards of the antitrust laws.' 321 U. S., at 85-86. The problem is one of accommodation of §5(2) and the antitrust legislation. The Commission remains obligated to 'estimate the scope and appraise the effects of the curtailment of competition which will result from the proposed [acquisition] and consider them along with the advantages of improved service [and other matters in the public interest] to determine whether the [acquisition] will assist in effectuating the over-all transportation policy.' 321 U. S., at 87.

"Even though such acquisitions might otherwise violate the antitrust laws, Congress has authorized the Commission to approve them, if it finds they are in the public interest, 'because it recognized that in some circumstances they were appropriate for effectuation of the national transportation policy. It was informed that this policy would be furthered by "encouraging the organization of stronger units" in the . . . industry. And in authorizing those [acquisitions] it did not import the general policies of the antitrust laws as a measure of their permissibility. It in terms relieved participants in appropriate [acquisitions] from the requirements of those laws. §5 (11).' 321 U. S., at 85. It must be presumed that, in enacting this legislation, Congress took account of the fact that railroads are subject to strict regulation and supervision. 'Against this background, no other inference is possible but that, as a factor in determining the propriety of [railroad acquisitions] the preservation of

competition among carriers, although still a value, is significant chiefly as it aids in the attainment of the objectives of the national transportation policy.' 321 U. S., at 85-86.

"As respects railroad acquisitions, the Commission is not so bound by the antitrust laws that it must permit them to overbear what it finds to be in 'the public interest.' A contrary view would, in effect, permit the Commission to authorize only those acquisitions which would not offend those laws. 'As has been said, this would render meaningless the exemption relieving the participants in a properly approved [acquisition] of the requirements of those laws . . . ' 321 U. S. at 86. Resolution of the conflicting considerations 'is a complex task which requires extensive facilities, expert judgment and considerable knowledge of the transportation industry. Congress left that task to the Commission "to the end that the wisdom and experience of that Commission may be used not only in connection with this form of transportation, but in its coordination of all other forms." 79 Cong. Rec. 12207. "The wisdom and experience of that commission," not of the courts, must determine whether the proposed [acquisition] is "consistent with the public interest."

" . . . Congress has left the task of making that determination to the wisdom and experience of the Commission. The determination it has made rests upon adequate findings which are, in turn, supported by substantial evidence and is well within the limits of its discretion under the Act."

Stockholder Intervention

It is quite possible that, in most unifications, there will be opposition from one or more stockholder groups based on allegations that the merger terms are not fair and reasonable insofar as the allocation of the stock of the surviving corporation is concerned. Unlike dissenting stockholders in indus-

trial mergers, dissenting stockholders in a railroad merger do not have appraisal rights. Their only redress, short of selling their shares on the market, is to intervene in the proceeding and to try to prove that the proposed division of the stock is not fair and reasonable. Such interventions have met with very little success and usually have the unfortunate result of delaying the proceedings.

THE RELEVANT MARKET—A CASE STUDY OF THE DuPONT-GENERAL MOTORS DECISION

by

GUY B. MASERITZ*

I. THE ANALYTICAL TECHNIQUE

A. *Introduction*

The concept of the market is based on two fields of study—economics and law. The legal concept has its roots in common law, and later adopts statutory form with the passage of the Sherman Antitrust Act in 1890. The Sherman Act vaguely defines the market as "any part of the trade or commerce among the several States or with foreign nations * * *"[1] The courts have been faced with the difficult task of giving substance to the law. In effect, the legal concept is derived from the evolutionary process of court litigation.

The economist's concern with the market is primarily confined to the problems of efficiency in the production and distribution of goods and services. Monopolization and restraint of trade should be avoided because they result in a malallocation of resources and inefficiency in production. According to the economist, an efficient system is one in which the distribution of goods and services is such that "it would be impossible to make anyone better off without making someone else worse off," assuming a given distribution of income.[2] Perfect competition is the theoretical framework of an efficient economic system. It necessitates certain prerequisite institutional conditions: (1) a large number of buyers and sellers; (2) absence of natural restraints on buyers and sellers, such as restrictions on entry into the market; and,

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1 Title 15, Section 2 (Act of July 2, 1890, 26 Stat. 209).

2 Tibor Skitovsky, *Welfare and Competition*, Chicago, Illinois, 1951, p. 55.

(3) an informed market. Under these conditions, the market determines the value or price of the goods being sold, and the seller becomes the price taker. The seller will produce up to the point where price equals marginal cost because at that level of production his profits are maximized. All sellers have the same price because they accept the market value. Under perfect competition, therefore, all sellers have the same price and marginal cost. If the seller raises his price, the consumer will shift to his competitors. The seller will not lower his price because, at the given price, he is able to sell all he desires. In technical terms, the seller has an infinitely elastic demand curve.

The economist might also consider the welfare aspects of the economy by refusing to accept the distribution of income as given. The welfare economist is concerned with equity as well as efficiency; he seeks some means of redistributing the income to create a more equitable situation. The evaluation of equity must be based, at least in part, on subjective factors. The efficiency argument, however, is a technical one based solely on objective factors. While equity is an important consideration in market analysis, it is not of crucial significance in the study of government regulation of business. Perfect competition, however, is of great importance in market analysis because it establishes a norm against which the actual imperfections of the economy may be compared.

Economics and law, while distinct fields of study, fuse in the area of government regulation of business. The economist provides the theoretical justification for antitrust action. On what grounds is Government action justified in combating "cut-throat competition?" Why is it necessary to curb monopoly power? The explanations are found in the concept of efficiency, an economic phenomenon. In fact, the rationale for a free enterprise system based on a market economy is derived from the concept of efficiency. The law serves in the capacity of protecting the competitive system against unnatural forces which tend to create monopoly and restrain

trade. The courts, however, are less concerned with the ideal norm than with the practical realities. The courts do not seek to establish perfect competition, but, instead, strive for the preservation of a healthy, competitive system.

The applied meaning of competition, however, is impotent without some concept of the relevant market. The term "market" refers to the exchange of goods and services. A consumer with a given income must decide between alternative goods. His income does not permit him to buy all goods in any quantity desired. In this sense, all commodities compete with one another. The relevant market, however, is a means of isolating those products which are directly competitive, i.e., the variations in sales and price of one product significantly affect the demand for the competing product. This process of substitution is measured by cross-elasticity of demand. Two products which have a high cross-elasticity of demand are close substitutes, and, likewise, a low cross-elasticity indicates poor substitutes. The market shall be defined according to the definition provided in the *Attorney General's Report on Antitrust Laws*:[3]

> The market is " * * * an economic relationship among sellers and buyers, whose boundaries are not necessarily defined by geographical area alone, nor by conventional product classifications * * * One should include in a market all firms whose products are in fact good and directly available substitutes for one another in sales to some significant group of buyers * * * "

The courts have adopted two distinct approaches to the problem of market delimitation. Initially, the courts distinguished products by their physical characteristics. The market analysis was based on the assumption that only physically similar products could be associated with the same market.

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[3] *Report of the Attorney General's National Committee to Study the Antitrust Laws* (March 31, 1955), p. 322.

Within the last ten years, however, the Supreme Court has broadened the scope of its analysis of the relevant market. Included in the relevant market now are all products which are functionally and economically interchangeable, regardless of their physical characteristics.[4] The interchangeability is determined by the consumer's willingness to substitute one product for another. The products are quantitatively measured for substituteability by cross-elasticity of demand, and qualitatively measured by a technical examination of the products. In effect, the new approach to market analysis differs from the old approach by the addition of four techniques of market analysis: (1) cross-elasticity of demand; (2) technical analysis of the functional relationship; (3) end-use; and (4) evaluation of the market by experts and manufacturers in the industry. These techniques will be discussed in the succeeding analysis. The development of these techniques is important because it reveals a new approach, on the part of the court, to market analysis—a greater dependence on detailed evidence of market conditions, as opposed to legal abstractions. The new approach is referred to as the analytical technique.

The purpose of this study is twofold: first, to examine the development of a new legal approach to the concept of the relevant market; and, second, to apply the new approach to an actual market situation, the market in this case being that of finishes as developed in the *duPont-General Motors* Supreme Court case of 1957. An examination will first be made of the court's earlier approach to market delimitation. The analytical technique will then be defined and developed.

B. *Pre-Analytical Approach to the Market*

1. *United States* v. *Paramount Pictures*

The earlier technique of market analysis, based solely on physical characteristics, has been delineated in the *Paramount*

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[4] For further analysis, see note 16, *infra*.

and *Alcoa* decisions. In *United States* v. *Paramount Pictures* (1948), the Government alleged that the tying agreement between the distributors and exhibitors of motion pictures created exclusionary practices resulting in the restraint and monopolization of interstate trade. The Supreme Court, while finding Paramount's activities in violation of Sections 1 and 2 of the Sherman Act, applied its own interpretation of the relevant market. Justice Douglas, in expressing the majority opinion, held that first- and second-run theatres had to be distinguished before a violation of the Sherman Act could be determined. The Court stated that "the main contest is over the cream of the exhibition business—that of the first-run theatres."[5] The distinction between first- and second-run fields was not necessarily one of physical peculiarities. At the time of the decision, films were generally considered to have had physically identical properties. In this case, the psychological and environmental conditions served as a basis for separating the fields. The consumer distinguished "uptown" and "downtown" movies because of publicity, price variation, and location. The Supreme Court's reversal was based on the lower court's failure to take these factors into consideration. In the words of the Court:

> "First, there is no finding on the part of the five majors in the first-run field for the entire country, in the first-run field in the 92 largest cities of the country, or in the first-run field in separate localities. Yet the first-run field, which constitutes the cream of the exhibition business, is the core of the present cases."[6]

The relevant consideration, for purposes of this study, however, is not what the Court explicitly stated, but, rather, what it implicitly excluded. There was no reference made to the other media of mass entertainment, including legitimate theatre, athletic contests, television, etc. All these forms of

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[5] *United States* v. *Paramount Pictures, Inc.*, 68 S. Ct. 933 (1948).

[6] *Ibid.*, p. 936.

entertainment were physically distinguishable, but, like the motion pictures, they all fell into the general category of entertainment. The underlying assumption prevailing throughout the entire context of the decision was that the relevant market contained only physically similar products. Motion pictures were physically distinct from television and legitimate theatre, and, therefore, *ipso facto,* were part of a separate market.

2. *United States* v. *Aluminum Co. of America*

United States v. *Aluminum Co. of America* is significant for two major reasons. First, the decision further exemplifies the position of the Court in regard to the question of relevant market. In the lower court's decision of 1945, Alcoa was held to be the sole domestic supplier of virgin aluminum ingot. It was concluded, therefore, that secondary aluminum (old scrap) had not been a competitive source of aluminum; consequently, it was held that Alcoa had violated Section 2 of the Sherman Act. The District Court, in considering remedies, found that the market situation had changed quite considerably from the pre-war period.[7] In 1950, the Court found Alcoa supplying about one-half of the market for domestic virgin ingot, the other half being controlled by Reynolds and Kaiser. It was held, therefore, that scrap aluminum served as a competitive product. The Court then proceeded to the most relevant argument, for purposes of this study. The Court held that even if Alcoa had dominated the primary source of aluminum, it would not have been sufficient evidence of monopolization because the relevant market was not confined to the source stage of production. The relevant market was defined as the "entire range of the aluminum products," including the user stage of production.[8] It was at the latter level of production that both the integrated producers and non-integrated fabricators competed

[7] *United States* v. *Aluminum Company of America,* 91 F. Supp. 357 (S. D. N. Y. 1950).

[8] *Ibid.,* p. 358.

for control of the sources of production (pig and ingot). Chief Judge Knox stated:

> "Since the major market competition takes place at the fabrication stage, the actual share held by the competitors—Alcoa, Reynolds, Kaiser and the non-integrated fabricators—is measured by the amount of metal which they can command in the fabrication stage as a result of their production or acquisition." [9]

Again, the important factor here is what has been excluded in the Court's decision. The aluminum market, whether confined to primary or secondary aluminum, was examined in terms of one physically distinct product—aluminum. The Court examined the various sources of aluminum and broadened the scope of the market to include all aluminum products; but one fact remains evident—the aluminum market was considered a separate and distinct market. The Court could have transcended the physical barriers and extended its scope of analysis to the production and "users" of copper, brass, tin, bronze, lead, steel and iron. These products compete with aluminum in the production of rods, cables, wires, building materials, rivets, containers, etc. The Court chose, however, to restrict the market to products with similar physical characteristics.

The second significant factor in connection with the *Alcoa* case is that the decision revealed a willingness on the part of the Court to break away from precedence, and examine the factual evidence on an individual case basis. While the Court failed to examine possible substitute products, it did express the following opinion: "The question as to whether secondary aluminum should be treated as a competitive element in the market for primary is one of fact, and not of law." [10] The reference to fact along with the Court's emphasis on the "user" market (as opposed to the "source" market),

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[9] *Ibid.*

[10] *Ibid.*

indicated a certain willingness to broaden the scope of analysis of the market to factors other than physical characteristics. The Court opened the way for a new approach to market analysis which was to appear in 1953 with the Supreme Court's decision of *Times-Picayune Publishing Co.* v. *United States.*[11]

C. *The Analytical Technique*

1. *Definition*

The recent approach to the concept of relevant market might be described as an analytical examination of commodities in order to isolate the highly competitive products. The factors of geographic location, price, quality, consumer taste, and end-use are all important elements in examining the market. However, these factors are significant in so far as they affect the consumer's final decision to substitute one product for another. In the words of the Supreme Court:

> "The 'market' which one must study to determine when a producer has monopoly power will vary with the part of commerce under consideration. The tests are constant. That market is composed of products that have reasonable interchangeability for purposes for which they are produced—price, use and qualities considered." [12]

There are two sides of the market which must be considered—the buyer and the seller. The concept of cross-elasticity serves as a quantitative measure of consumer behavior. A high cross-elasticity between two commodities denotes substitute products, such that a rise in the price of one will cause the consumer to shift purchase to the other competing products. If the cross-elasticity is small, the consumer is not as sensitive to price differentials between

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11 The initial change actually appeared in 1953 with the District Court's holdings in the *Cellophane* case; however, the Supreme Court did not affirm the lower court's decision until 1955.

12 *United States* v. *E. I. duPont de Nemours*, 351 U. S. 1012 (1955).

the two commodities. Complementary to the technique of cross-elasticity is the technical examination of the products for qualitative peculiarities. A product may have a peculiar physical characteristic which makes it functionally distinct;* technical analysis provides another measure of substituteability. End-use of the products is also an important tool in the analytical concept. Products are frequently used for the same purpose, while possessing distinct physical characteristics. Technical data can be applied to end-use analysis in determining functionally distinct products.

On the other side of the market, the behavior of the seller provides some insight into the market situation. The most direct method of evaluating the market boundaries is to have the producers and experts evaluate the market based on their own first-hand knowledge and experience. In summary, cross-elasticity measure, technical data, end-use, and expert opinion are the basic tools of the analytical technique of market analysis.

2. *Times Picayune Publishing Co.* v. *United States*

The first substantive appearance of the analytical technique occurred in *Times-Picayune Publishing Co.* v. *United States*. *Times-Picayune* and the *States* were two newspapers owned by the same company, the former being the only morning newspaper issued in New Orleans, and the latter, an evening newspaper in competition with the *Item*. The Government contended that the tying arrangement, whereby all advertisers desiring space in the morning *Times-Picayune* had to advertise also in the evening *States,* was in violation of Sections 1 and 2 of the Sherman Act. The Government argued that the relevant market should be confined to the morning newspaper; the defendants contended that the mar-

* The reference to physical properties should not be confused with physically distinct products. In the former context, products with the same uses are distinguished by their physical attributes and weaknesses. In the latter sense, products are distinct because of general characteristics, without reference to their functions.

ket should include all forms of advertising media competing with the newspapers, such as radio, television, magazines, etc.

The Court rejected both contentions. Every newspaper, according to the Court, sells two products—the news and advertisements. The product in question was advertising readership in the form of general and classified linage; since both the morning and evening newspapers sold this product, they were included in the same market. The Court stated that " * * * nothing in the record suggests that advertisers viewed the city's newspaper readers, morning or evening, as other than fungible customer potential. We must assume, therefore, that the readership 'bought' by advertisers in the *Times-Picayune* was the selfsame 'product' sold by the *States*, for that matter, the *Item*." [13]

On the other hand, the Court concluded that the other media of advertising were not part of the relevant market. A product is competitive only when a "reasonable variation in price" results in a significant change in consumer demand.[14] In effect, the test was an application of the concept of cross-elasticity of demand, and served as the first of four major techniques of analytical evaluation. The heart of the Supreme Court's decision, for purposes of this paper, is found in a footnote:

> "For every product, substitutes exist. But a relevant market cannot meaningfully encompass that infinite range. The circle must be drawn narrowly to exclude any other product to which, within reasonable variation in price, only a limited number of buyers will turn; in technical terms, products whose cross-elasticity of demand are small. Useful to that determination is, among other things, the trade's own characterization of the products involved. The advertising industry and its customers,

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13 *Times-Picayune Publishing Company* v. *United States*, 73 S. Ct. 883 (1953).

14 *Ibid.*, p. 882, Note 31.

for example, markedly differentiate between advertising in newspapers and in other mass media." [15]

The above paragraph was the turning point in the Court's approach to market analysis. First, cross-elasticities were introduced as a quantitative measure of substitute products. Second, the use of the word "substitute" signified that the Court no longer considered the relevant market to be bounded by physical peculiarities; regardless of the physical appearance of products, the relevant market was composed of those commodities which had high cross-elasticities of demand. Finally, the Court relied on actual market conditions in limiting the market. In referring to the "trade's own characterization," the Court introduced the second major technique of analytical analysis. Based on this technique, the producer's evaluation of the market is of particular relevance. The third and fourth techniques involving the examination of the physical properties and end-uses of the products will be more thoroughly covered in the *Cellophane* case.

The Court in *Times-Picayune* did not include physically distinguishable products in the same market, but the significant fact was the Court's recognition of a possible market situation, where two physically distinct products might compete. The stage was set for further expansion in market analysis. The real test was to appear in 1955 with the *Cellophane* decision.

3. *United States* v. *E. I. duPont de Nemours & Co.*

United States v. *E. I. duPont de Nemours & Co.* was initiated by the Government as a civil suit in the United States District Court for the District of Delaware in 1953. The duPont Company was charged with violating Section 2 of the Sherman Act in attempting to monopolize trade and commerce in the cellophane industry. The Government contended that duPont possessed sufficient monopoly power to arbitrarily raise prices and exclude competition.

[15] *Ibid.*

The determination of monopoly power rested on the Court's definition of the relevant market. The Government contended that the cellophane market was distinct and separate from the market for flexible wrappings. DuPont argued that the relevant market included all flexible packaging materials, and that the other forms of wrappings were functionally and economically interchangeable with cellophane. The District Court defined its position in the following statement:

> "Cellophane is not a unique flexible packaging material in any functional or economic sense. In terms of uses for which cellophane is sold, and the qualities it brings to each use as a wrapping material, cellophane is interchangeable and, in fact, continually interchanged with many flexible packaging materials." [16]

The reference to "fact" was perhaps the key to the Court's approach to market analysis. The Court held that the wrappings were both functionally and economically interchangeable. Fundamentally, products are functionally interchangeable when they have the same end uses; but the final analysis depends on certain intermediary steps. First, it was necessary to analyze the physical properties of the products in order to determine their functional limitations and advantages. Second, the opinions of impartial experts were used for evaluating the relevant product market. Finally, examination of actual end uses for the products was made in order to determine the functional relationship.

Economic interchangeability is primarily derived from cross-elasticity of demand. Substitute products are those commodities whose demand is significantly affected by a slight change in a competitor's price. Consequently, prices and output figures are instrumental in cross-elasticity analysis. Justice Reed, in expressing the views of the Supreme Court in a later appeal, presented the following views on cross-elasticity:

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[16] *United States* v. *duPont de Nemours & Company,* 118 F. Supp. 63 (D. Del. 1953).

"An element for consideration as to cross-elasticity of demand between products is the responsiveness of the sales of one product to price changes of the other. If a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between them; that the products compete in the same market."[17]

The analytical approach in the *Cellophane* case was based on a detailed examination of the actual market conditions. It has been pointed out that the functional interchangeability of cellophane and other flexible wrappings was based on three factors—physical properties, expert opinions, and end-use. In the first case, exhibits were submitted to the Court, comparing the physical properties of cellophane with other flexible packaging materials. Included in the list of relevant products were aluminum foil, cellulose acetate, Cry-O-Rap, glassine and grease-proof paper, pliofilm, polyethylene film, waxed paper and sulphate paper. Each one of these products was compared for heat sealability, printability, clarity, tear strength, twisting strength, water absorption and moisture permeability. It was found that each of the wrappings offered its own functional advantages and disadvantages—cellophane had high transparency but poor tearing strength; aluminum foil lacked heat sealability but maintained good printability; glassine was opaque but of high tear strength, etc. Hundreds of exhibits were presented displaying various aspects of production, physical composition, prices, output, etc. Buyers, sellers, and experts testified on their views of the relevant market based on their experiences and observations. Representatives from such packaging firms as Curtiss Candy Company, Kraft Foods, National Biscuit Co., and Armour Co., as well as witnesses from competing wrapping manufacturers gave testimony. Research personnel, statisticians, and editors were used as expert witnesses. Trade journals and texts were

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17 *United States* v. *duPont de Nemours & Company,* 351 U. S. 1010.

utilized as authoritative sources of information. The members of the Supreme Court even went so far as to attend a Packaging Exposition (which was held in Atlantic City during the period of the trial) in order to observe the sales and promotional activities of the producers of flexible packaging materials.

Finally, an examination of the end-uses of the flexible wrappings was made. It was found, for example, that waxed paper and glassine competed with cellophane in wrappings for bakery products, aluminum foil in candy, glassine in snacks, pliofilm and waxed paper in meats, and polyethylene, waxed paper, waxed glassine and pliofilm in frozen foods. Other end-uses included wrappings for cereals, cheese, cigarettes, and miscellaneous products. It was this combination of factual evidence—documentary, oral and physical—upon which the Court based its evaluation of the functional interchangeability of flexible wrappings. The District Court summarized the significance of functional analysis in market delimitations:

> "(The) nature of (the) market must be based on proof. DuPont by evidence makes speculation superfluous by bringing facts of the market place to the surface. It includes identity and nature of other flexible packaging materials, analysis of uses within trade prices, variety of factors governing selection of one wrap over another, business conditions that vary these factors from one end use to another, character, purpose and effect of promotion and research activities of different manufacturers, thrust of advertising and trade literature, and effect of competition in actual paying customers gained, lost, divided and shifted." [18]

The economic factors were also presented to the Court in the form of exhibits. The Court reviewed average wholesale prices of the various packaging materials. Figures of the

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18 *United States* v. *duPont de Nemours & Company*, 118 F. Supp. 198.

prices per 1000 square inches of wrapping, as well as prices per pound, were submitted in evidence. Sales were measured in millions of square inches for each relevant commodity. The statistical data covered the period from 1924 to 1950. Based on the evidence submitted, the Court concluded that duPont had not endeavored to achieve a position of price control and that cellophane's higher prices represented a disadvantage to its sales. Moreover, the Court was of the opinion that duPont's price reductions were the result of efficient production and increased volume of sales. The District Court summarized its position in the following manner:

> "This range of properties and price is the product of competitive influences in the market; of technical advances of manufacturers, of efforts to widen (the) market and reduce prices; and of arrival on the scene of new packaging materials." [19]

The District Court concluded that the relevant market was the entire market for flexible packaging materials. It was held that duPont competed with other wrapping manufacturers in "quality, service, and price," and, therefore the defendant had not monopolized the cellophane market. The Supreme Court reviewed the District Court's opinion in 1955, and affirmed its decision.

The *Cellophane* case was the first significant application of the analytical technique of market analysis. Factual evidence in the form of exhibits, expert witnesses, documents and published literature served as substitute for theoretical interpretation. The question remained as to whether the succeeding cases involving issues of the relevant market would be examined in the light of the *Cellophane* doctrine of analytical evaluation.

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[19] *Ibid.*, p. 199.

II. DuPont-General Motors Case

A. *District Court Decision*

United States v. *E. I. duPont de Nemours & Co., et al.*, was initiated by the Justice Department in the United States District Court for the Northern District of Illinois in June of 1949. The complaint was filed against General Motors, U. S. Rubber Co., and two holding companies controlled by members of the duPont family, as well as the duPont Company itself. The Government alleged that duPont, through a 23% stock acquisition in General Motors, gained a non-competitive position in the sale of fabrics, finishes and other automotive products to General Motors. It was charged that Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act had been violated. The District Court reviewed the history of duPont's stock acquisition in the U. S. Rubber Co. and General Motors. The purchasing policies involving finishes and fabrics made by the defendants were also examined. It was concluded that each division within the General Motors Corporation had its own independent purchasing policy, and that the trade relationship between General Motors and duPont was based strictly on the sale of a superior product rather than collusive agreement. Likewise, in the sale of fabrics, the Court concluded that duPont had always maintained a prominent sales position with General Motors, even before the stock acquisition. Justice LaBuy, in examining the historical relationship between duPont and General Motors, stated:

> "Before the stock purchase in late 1917, duPont was supplying substantially all the coated fabric requirements for both upholstery and top material for Chevrolet and Oldsmobile; about one-half for Buick; about one-third for Oakland; and all interior trim for Cadillac, but none of the top material."[20]

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[20] *United States* v. *E. I. duPont de Nemours and Company, et al.*, 126 F. Supp. 297 (N. D. Illinois 1954).

While the Court did not examine the question of relevant market, it did reject the Government's estimates on the percentage sales of fabrics by duPont and its competitors to General Motors. The Court upheld duPont's contention that imitation leather products were used for purposes other than automotive fabrics.

The Court concluded that duPont had achieved its market position through competitive means and that no violation of either the Sherman Act or Clayton Act had occurred.

B. *Supreme Court Decision*

1. *Majority Opinion*

The case was brought before the Supreme Court on direct appeal on June 3, 1957. The Supreme Court's approach to the issues in question differed quite radically from the analytical examination made by the lower Court. The main emphasis was now on Section 7 of the Clayton Act, which had been only briefly covered in the District Court's decision. Moreover, the findings of the lower Court were circumvented for a more general analysis of the issues.

There were three fundamental issues arising out of the Supreme Court's interpretation of the Clayton Act. First, the Court held that the Clayton Act, prior to the Cellar Amendment, covered vertical as well as horizontal acquisition. Consequently, Paragraph 1 of Section 7 referred not only to competing corporations, but "also to corporate acquisition of stock of any corporation, competitor or not, where the effect may be either (1) to restrain commerce in any section or community, (2) tend to create a monopoly of any line of commerce." [21]*

[21] *United States* v. *E. I. duPont de Nemours and Company, et al.*, 353 U. S. 876 (1957).

* Section 7 of the Clayton Act states:

"Section 7. That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of another corporation engaged also in commerce, where the effect of such acquisition be to (1) substantially lessen competition between the corporation whose stock is so

Second, the Court held that the Government was free to bring action against a stock acquisition at any time when there was a danger of lessening competition, restraining commerce or creating monopoly. The time chosen by the Government in bringing action was the controlling factor, rather than the time of acquisition. As the Court expressed it, "'Incipiency' in this context denotes not the time the stock was acquired, but any time when the acquisition threatens to ripen into a prohibited effect."[22]

Finally, the Court defined the relevant market as the market for automotive finishes and fabrics, rather than the entire market for all such products. In the words of the Court, "The record shows that automotive finishes and fabrics have sufficient peculiar characteristics and uses to constitute them products sufficiently distinct from all other finishes and fabrics to make them a 'line of commerce' within meaning of the Clayton Act."[23] Justice Brennan concluded, on the basis of this definition, that the adverse effect on competition had been "substantial." General Motors accounted for almost 50% of the total sales in the automotive industry; and duPont supplied 67% of General Motors' requirements for finishes in 1946, and 68% in the following year, while supplying 52% of its requirements for fabrics in 1946, and 38% in 1947. It was evident, therefore, according to the Court, that both "quantitatively and percentagewise DuPont supplied the largest part of General Motors' requirements * * *"[24]

Once the Court had determined the relevant market and established its substantiality, it went on to show that duPont did not achieve a commanding position in the sale of fabrics and finishes to General Motors on competitive merit alone. On the contrary, duPont had gained an advantage on the

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acquired and the corporation making the acquisition, or (2) to restrain such commerce in any section or community, or (3) tend to create a monopoly of any line of commerce.

[22] *Ibid.*, p. 879.

[23] *Ibid.*, p. 877.

[24] *Ibid.*, p. 879.

basis of its 23% stock interest in General Motors. The basis for evidence was certain letters and documents from representatives of the duPont company. Justice Brennan stated, "The fact that sticks out * * * is that the bulk of duPont's productions has always supplied the largest part of the requirements of the one customer in the automobile industry connected to duPont by a stock interest." [25]

The Court concluded that duPont had violated Section 7 of the Clayton Act, and, therefore, the judgment of the District Court was reversed. The case was remanded to the District Court for determination of the penalty.

Before presenting the District Court's decision, it might perhaps be valuable to summarize the position of the minority. There are two main reasons for reviewing the minority decision. First, the "liberal" coalition of Justices Brennan, Warren, Black and Douglas formed the majority in a 4-2 decision. It is argued by some that had there been a full Court with Justices Clark, Harlan and Whittaker participating, the decision might have taken a different turn. Second, a presentation of the opposing views might help to clarify the controversial issues in the case.

2. *Minority Opinion*

The dissenting opinion was presented by Justices Burton and Frankfurter. They were of the opinion that the Court had erred in all three of its interpretations of the Clayton Act. First, in reference to the application of Section 7 to vertical integration, the minority argued that precedents failed to substantiate the Court's view. Reference was made to *International Shoe Co.* v. *FTC,* where the Court held that substantial pre-existing competition was a requisite for violation of either clause of Section 7.

Second, the minority objected to the position of the Court in holding that the time chosen by the Government in bringing action was controlling rather than the time of stock

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[25] *Ibid.*, p. 883.

acquisition. In the words of the two dissenting Justices: "The fact of continued holding does not allow the Government to dispense with the necessity of proving that the stock was unlawfully acquired."[26] In addition, the Justices contended that any evidence or facts arising after the actual acquisition should be used as evidence only in regard to the threat of competition at the time of acquisition.

Finally, the minority disagreed with the Court's holding that the facts of the case fell within the theory of illegality. First, it was felt that duPont's commanding position had been achieved through competitive means rather than stock interest. The Justices argued that the products sold to General Motors—Duco, Dulux, Fabriloid and Fabrilite—were successful because of quality, service and price. Furthermore, it was argued that Ford's policy of making most of its own finishes and fabrics, and Chrysler's policy of selecting a single supplier for each product were significant explanations for duPont's market position. General Motors, Ford and Chrysler accounted for 85% of automotive production.

Secondly, the minority objected to the reliance of the Court on certain documentary evidence (such as letters and reports of Raskob, Haskell and others) to prove duPont's intent to secure a non-competitive position. As the Justices expressed it: "Each of them (letters and reports) is a matter of disputed significance. which cannot be evaluated without passing on the motivation and intent of the author. There was no evidence of restriction on General Motors freedom to buy as it chose."[27]

Lastly, the minority argued that the relevant market was not that of automotive finishes and fabrics, but, rather the entire market for industrial finishes and fabrics. On the basis of the total market for finishes and fabrics, duPont's sales accounted for less than 3.5% of the national market for in-

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[26] *Ibid.*, p. 891.

[27] *Ibid.*, p. 903.

dustrial finishes (as opposed to 34% of automotive finishes) and around 1.6% of the national market for industrial fabrics (as opposed to 19% of automotive fabrics).[28] The Justices contended that the Court failed to clearly define what it meant by "peculiar characteristics" of the automotive finishes and fabrics. Based on the findings of the lower court, the minority concluded that the automotive products could not be distinguished from their respective industrial counterparts.

C. *The Penalty*

The District Court concluded its hearing on October 2, 1959. The Government's plan had called for a complete divesture of duPont's sixty-three million shares of stock in General Motors over a ten-year period. Two-thirds of the shares were to be distributed *pro rata* to the shareholder in the form of a dividend. The remaining one-third was to be placed under the jurisdiction of a court-appointed trustee to be gradually sold over the ten-year period.

DuPont's plan called for a partial divestiture in the form of a "pass through" of voting rights, whereby duPont would maintain the same financial benefits from the stocks but would lose its voting privileges. The duPont stockholders would have the votes "passed through" to them in proportion to their present holdings.

The Court adopted the duPont plan along with other peripheral demands—interlocking directorates were prohibited and all business relations between duPont and General Motors were to be terminated for a three-year period following entry of the final judgment.

The Government once again appealed to the Supreme Court and on May 22, 1961, the Court ruled in favor of the Government's plan for complete financial divestiture. The duPont plan was inadequate because, in the words of the Court, "divestiture only of voting rights does not seem to us

[28] *Ibid.*, p. 908.

to be a remedy adequate to promise elimination of the tendency of duPont's acquisition offensive to Section 7." [29] DuPont was directed to commence divestiture within ninety days and to complete divestiture within a ten-year period, effective as of the date of the District Court's judgment.

III. The Finishes Market

A. *Introduction*

The Supreme Court, in its 1956 duPont decision, concluded that the market for automotive finishes and fabrics possessed sufficient "peculiar characteristics and uses" to be assigned a separate market category. The Court supported its decision with extensive statistical data but excluded an analytical examination of finishes and fabrics in its analysis of the market. In this section, an effort has been made to examine the market for peculiar characteristics and uses, in order to determine whether automotive finishes and fabrics constitute separate market categories.*

There are four possible areas of research for an analytical examination of the market: cross-elasticity of demand, end-use, technical analysis and evaluation of the market by experts and producers. The measurement of cross-elasticity, by necessity, is excluded in the succeeding analysis. While the variations in price and output would be of infinite value in examining for substitute products, the necessary statistics and data are not available to the public. There are two explanations for the difficulty in obtaining data. First, the companies producing automotive finishes do not publish either retail or wholesale prices on their automotive products. Secondly, the diversity of automotive products (primers, under-

[29] *United States* v. *E. I. duPont de Nemours and Company, et al.,* 81 S. Ct. 1253 (May 22, 1961).

* Automotive fabrics will not be examined in this study because of insufficient data. The company response to my inquiries was negligible.

coats, exterior finishes, interior finishes) reduces the effectiveness of price-elasticity analysis. The evaluation of substitute products, therefore, is confined to a technical analysis of automotive finishes. The three remaining analytical techniques are applied to the market study.

A necessary prerequisite to an analysis of industrial finishes is a basic familiarity with the technical terms and characteristics of the products involved. Therefore, an attempt has been made to present certain fundamentals on the chemical composition of finishes. Based on this background, the analysis proceeds to an examination of the three major automotive finishes in an effort to determine their degree of interchangeability. Automotive finishes are then compared with other industrial finishes and classified according to end-use. The findings are culminated with a summary of the opinions of experts in the field of coating and plastic technology.

B. *Technical Background*

The term *paint* describes all finishing materials, and encompasses a wide variety of products with varying properties and uses. Included in the broad category of paints are lacquers, enamels, sealers, primers, surfacers and putties. These finishes are chemical compounds applied to a surface for purposes of protection and/or decoration. In general, paints are composed of three basic elements—vehicles, solvents, and pigments. An attempt will be made to describe each element and its function.

A vehicle might be defined as "that portion of the paint in which the pigments are dispersed. . . . In a way it acts as a sort of liquid glue or 'binder' for our pigment." [30] The vehicle is composed of non-volatile and volatile parts, the former being that portion which serves as a binder, and the latter, that portion which leaves the film on application, thus

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[30] Elias Singer, *Fundamentals of Paint, Varnish and Lacquer Technology*, St. Louis, Missouri, 1957, p. 8.

affecting the application properties as well as the actual physical and chemical properties. A vehicle may take the form of a resin, plasticizer, oil or drier, and normally requires some combination of two or more of the four elements. A resin is "normally (a) transparent or translucent solid or semi-solid of either vegetable or synthetic origins." [31] It serves many functions, such as improving gloss, adhesion, resistance, hardness and drying. A few examples of popular resins are alkyds, acrylics and phenolics—all of which are synthetics—and rosin, kauri, copal and congo—all of which are natural. Nitrocellulose is a plastic possessing many of the attributes of resin. It has the "advantage of speed, relative low cost, durability, flexibility and toughness," [32] along with disadvantages of yellowing and flammability. In some cases, the synthetics and natural resins are cooked with oil for permanence and flexibility, depending on end-use. The plasticizer is an agent in the film serving to maintain flexibility. A plasticizer must meet certain requirements before it is a useful agent; in particular, it must be compatible with resins and nitrocellulose, non-yellowing and chemically stable. The drier serves as a catalyst, accelerating the drying of the film. A drier may take the form of lead, manganese, iron, zinc, calcium or cobalt.

The pigments and solvents are the two remaining basic ingredients in the formulation of paint. The pigment is "that portion of the paint which is insoluble in the vehicle." [33] Its main function is to provide color to the film, although pigments also add opacity, strength and hardness. A few examples of pigments are titanium dioxide (white), carbon (black), lead chromate (yellow), and phthalocyanine (blue and green). The solvent is used to "reduce the film-forming components to a

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31 *Ibid.*, p. 29.

32 Joseph J. Mattiello, *Protective and Decorative Coatings*, New York, 1943, Vol. I, p. 500.

33 Singer, *op. cit.*, note 30, *supra*, p. 63.

satisfactory consistency for application."[34] Solvents appear in many forms, including esters, mineral spirits, and turpentine.

The analysis of paint composition has been presented in a most elementary manner; however, even this brief presentation reveals the complexity of paint formulations. Even if the examination of paints were limited to a study of vehicles, the undertaking would be enormous. There are numerous kinds of resins, plasticizers, driers and oils. But the real complexity arises with the infinite number of possible combinations of these chemicals. It is not unusual to find a vehicle composed of two or more different resins. The late Joseph Mattiello, an expert on paint technology, has written that "a single resin will not always give the desired results so that the lacquer chemist must find out by experimentation what combinations of resins, with plasticizers and nitrocellulose, will produce a film that will meet service requirements."[35] The situation is even more emphatic with solvents because "no one solvent possesses all the requirements necessary. The ideal solvent should be a good solvent for both the nitrocellulose and the resin or resins in the lacquer."[36]

C. *Automotive Finishes*

Most finishes contain the three basic ingredients, and automotive finishes are no exception. There are three major types of automotive finishes: nitrocellulose lacquer, synthetic enamel and acrylic lacquer.* The nitrocellulose lacquers are normally composed of five basic ingredients; the alkyd resin is included in the following list, but is not necessarily found in all nitrocellulose lacquers:

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[34] Henry Fleming Payne, *Organic Coating Technology*, New York, 1954, Vol. I, p. 41.

[35] Mattiello, *op. cit.*, note 32, *supra*, Vol. III, p. 520.

[36] *Ibid.*, p. 510.

* It may be argued that the alkyds form a fourth category. The above three categories of automotive finishes are based on the observations of R. P. Ericson, assistant division technical director of Pittsburgh Plate Glass Company. Mr. Ericson has included the alkyds as part of the enamels and nitrocellulose lacquers.

1. Nitrocellulose, which is made from chemically treated cotton linters or wood pulp.
   Alkyd resins, for durability and gloss retention.
2. Plasticizer, for flexibility of the film.
3. Stabilizer.
4. Solvents, which are added "solely for application purposes and impart no residual properties to the film since they evaporate completely as the lacquer dries."[37]
5. Pigments, which give color to the lacquer and add durability.

The enamels used on automobiles also contain alkyd resins (although not in every instance) which have been modified by urea and melamine compounds for purposes of improved hardness, gloss retention, and general exterior durability. The solvents and pigments used in the enamels are "chosen for the same reasons as they would be for lacquers," depending on finish desired and method of application.[38] Finally, there are acrylic lacquers which are based on an acrylic resin vehicle. The resin is normally combined with a plasticizer, solvent and pigment, all of which are "chosen for the same reasons as they are for nitrocellulose lacquers."[39] The following table, comparing the major ingredients, may assist the reader in distinguishing the chemical compositions of the automotive finishes:[*]

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[37] R. P. Ericson, Assistant Manager of Paint Division for *Pittsburgh Plate Glass Company*, personal communication of May 1, 1961.

[38] *Ibid.*

[39] *Ibid.*

[*] Again, this table is an oversimplification; the type of resin used in nitrocellulose or enamel is not limited to alkyds.

	NITROCELLULOSE	ENAMELS	ACRYLIC
VEHICLE	1. Nitrocellulose 2. Alkyd resin 3. Plasticizer	—Alkyd resin —urea and melamine resin	—acrylic resin —plasticizer
SOLVENT	Used for purposes of drying	Normally baked	Same as nitrocellulose
PIGMENT	Color and durability	same	same

The apparent difference in the finishes is found in the vehicle element. The composition of acrylic, for example, is completely different from that of nitrocellulose; their similarity is confined to drying methods. Enamels, unlike nitrocellulose and acrylic compounds, are normally baked onto the surface. Solvents and pigments perform the same general function in the acrylic, nitrocellulose and enamel compounds, but the kind of solvent or pigment used will depend on the end result desired, method of application, and the vehicle employed. The three vehicles under examination have been studied for their "plus and minus" features by the Lily Varnish Company.[40] The following table summarizes the findings:[**]

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[40] *Lilly Varnish Company* Bulletin on "Industrial Product Finishes," sent in a personal communication from A. F. Mundt, Director of Sales for the *Lilly Varnish Company*, on April 19, 1961.

[**] Dr. Ralph Witt, associate professor of plastics technology at Johns Hopkins University, has assisted me in the presentation of this table.

TABLE A

ALKYD	ACRYLIC	NITROCELLULOSE
(+) Good durability and weather resistance	(+) Good durability	(−) Relative inferior durability
(+) High solid content	(−) Low solid content	(−) Low solid content
(+) Moderate cost	(−) High cost	(+) Moderate cost
(+) Low cost solvent	(−) High cost colvent	(−) High cost solvent
Good color retention; high gloss	(+) Superior color retention	(−) Inferior color retention.
Fair chemical resistance; good heat and abrasion resistance.	Good chemical resistance; good heat and poor shock resistance.	Fair chemical resistance; poor heat and good mar resistance.
Can be baked or air-dried	Air-dried	Air-dried

(+) — Signifies an important positive quality.

(−) — Signifies an important negative quality.

The question that naturally arises from this analysis is whether the three automotive finishes are substitute products. Since there are no available figures on price and output of the company products, we must confine the question to a technical or qualitative inquiry. In contrasting the finishes, three factors must be taken into account: cost, drying techniques, and end performance. Table A indicates that the resins and solvents used in acrylic compounds are more expensive than those used in nitrocellulose or alkyd compounds. Alkyds are least expensive because of low cost resins and solvents. The method of drying finishes is also important in distinguishing automotive finishes. Enamels are normally baked on the automotive part while lacquers (nitrocellulose or acrylic) are dried by a process of solvent evaporation. A manufacturer equipped to bake a finish is not likely to switch to an air-drying lacquer. Even the air-dried enamels differ from the acrylics in baking schedule, the latter requiring a much lower oven temperature to drive off the solvent. Performance is the last factor in examining for substitute products. The experts agree that nitrocellulose lacquer is inferior in durability and gloss retention to both enamel and acrylic compounds. Acrylics and enamels, while almost equal in field performance, vary considerably in cost.* Consequently, it may be concluded that, based on performance, cost and drying techniques, the three automotive finishes are not substitute products.

D. *Automotive* vs. *Industrial Finishes*

The question of particular relevance to this study remains unanswered. How do automotive finishes differ from the non-automotive finishes? There are three areas to be examined: (1) classification; (2) end-uses (including an analysis of technical and chemical properties); and (3) expert evaluation of the market.

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* Again, these findings are based on the observations of R. P. Ericson.

(1) Classification:

There are two major categories of finishes—architectural and industrial. The average home-owner is familiar with architectural finishes because they are generally used for the interior and exterior painting of homes. The consumer has easy access to these paints through his local hardware store. Industrial finishes, however, are rarely purchased by the average consumer, although his contacts with them are numerous. In contrast to architectural finishes, industrial finishes are "used on a wide variety of substrates which include metal, wood, plastics, textiles, paper, leather, and rubber. They also differ from architectural finishes in method of application and drying schedule."[41] Industrial finishes are used on an extensive variety of products, including automobiles, tractors, lawn mowers, airplanes, furniture, bridges, pencils, paper, appliances, boilers, machine tools, toys, golf balls, and lamp shades. The problem is finding a convenient and accurate basis for subdividing the varied product finishes. There are four areas of consideration in the classification of industrial finishes: (1) the surface to which a finish is applied; (2) chemical composition; (3) method of application and drying; and (4) end-use. Classification according to surface does not adequately distinguish industrial finishes. There are a vast number of finishes within each category. Wood exemplifies the complexity of surface classification. In addition to the variety of available finishes, there are numerous species of woods, including walnut, plywood, mahogany, fruitwood, pine and maple. Some of these woods serve in different capacities, such as indoor or outdoor furniture, panelling, wood floors, etc. The same complexity exists with metal surfaces. There are finishes for appliances, metal furniture, bridges, automobiles and airplanes. It is apparent, therefore, that a more articulate classification is required.

Classification based on chemical composition also creates a problem of complexity. First, the ingredients and formula-

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41 Payne, *op. cit.*, note 34, *supra*, New York, 1961, Vol. II, p. 1165.

tion of a finish depend on its end-use and the individual specifications of the consumer. Second, a desired property in a finish can be normally achieved by more than one formulation. The Lilly Varnish Company has published the following list of resins which will produce the same property when correctly formulated:[43]

DESIRED PROPERTY	RESIN TO USE
Abrasion resistance	Vinyl, alkyd, chlorinated rubber, epoxy, urethane.
Acid resistance	Chlorinated rubber, vinyl, hydro-carbon, phenolic, acrylic, epoxy.
Alkali resistance	Hydrocarbon, vinyl, acrylic, phenolic, chlorinated rubber, epoxy, ethyl cellulose, styrene, melamine formaldehyde, styrenated alkyd.
Color retention	Silicone, acrylic, amine formaldehyde, cellulose acetate butyrate, vinyl acetate.
Fast air dry	Nitrocellulose, chlorinated rubber, styrenated alkyd, alkyd, ethyl cellulose, catalyzed urea, phenolic, epoxy.
Fast baking	Amine formaldehyde, styrenated alkyd, chlorinated rubber, thermosetting and catalyzed phenolic, catalyzed epoxy.
Flexibility	Alkyd, vinyl, ethyl cellulose, vinylidene chloride, solubilized rubbers.
Hardness (absence of tack when warm; marproofness)	Amine formaldehyde, thermosetting phenolic.
Heat resistance	Silicone, non-drying alkyd, epoxy, triazine formaldehyde.

[43] *Lilly Varnish Company* Bulletin, *loc. cit.*, note 40, *supra*.

DESIRED PROPERTY	RESIN TO USE
Low cost	Tall oil vehicles, styrene modified vehicles, ester, gum, hydrocarbon, some natural resins as oleoresinous varnishes.
Oil and grease resistance	Vinyl, cellulose acetate, polyamide, phenolic, amine formaldehyde, cellulose nitrate.
Outdoor durability	Silicone, alkyds, cellulose acetate, cellulose acetyl butyrate, silicone alkyds, acrylic.

Finally, it is possible to alter the performance of a finish by simply varying the ratio of ingredients. Henry Payne, a noted author on paint technology, writes the following:

> "In view of the complexity in formulation of industrial finishes, it would be impractical to attempt to provide specific formulas for all possible types. . . . In all cases, it should be realized that even basic formulas vary in performance depending on source of material used and difference in manufacture and application of finish." [43]

A chemical analysis (physical and chemical properties) is more practically combined with the analysis of end-use in terms of desired properties of finishes. The same reasoning applies to the techniques of application and drying. There are numerous methods of applying a finish—dip, spray, roll, brush—and the formulations will vary somewhat to meet the particular requirements of each method. The technique of application will depend upon the end product. The same is true of drying techniques.

(2) End-Uses:

The second factor under consideration is the end-use of products. In the analysis of finishes, end-use classification

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[43] Payne, *op. cit.*, note 34, *supra*, Vol. II, p. 1166.

provides the most practical basis for distinguishing finishes. In order to facilitate end-use classification, industrial products are divided into two main categories—exterior and interior products. A product must fall into one of these two categories, regardless of the surface, technique of application and drying, or end-use. The end-use of a product will determine the necessary physical and chemical properties of a finish. Tables B1 and B2 compare the basic physical and chemical properties required for automotive and appliance finishes.

The distinction in chemical and physical properties between automotive and appliance finishes brings to bear the essential difference between all industrial finishes—the variation in end-use. Automotive finishes must meet certain performance requirements before they are useful to the automotive manufacturer. Table B2 indicates that there are a number of similar chemical properties, but, at the same time, reveals certain distinctions. Chemically, automotive finishes must be gasoline-, thermal-shock-, and weather-resistant, while appliance finishes must be resistant to grease, alkali and stains.* Practical experience with appliances and automobiles will assist the reader in understanding these differences. An automobile finish is subjected to environmental or outdoor conditions. Thermal-shock refers to a sudden change in temperature. This condition may take the form of a sudden cold wave or a summer trip to the mountains. Weather resistance requires a finish capable of withstanding severe rain, snow, hail, dust, stones, dirt and sunlight. These conditions are present for many "exterior" products, such as vehicles or bridges. Each, however, has its own individual requirements: airplanes travel at high speeds and altitudes; freight cars haul rocks, cement and chemicals; farm and garden equipment encounter chemicals in the form of fertilizers and insecticides; bridges are subjected to salt water, etc. Automotive finishes fall into the category of exterior finishes.

* These are the distinguishing chemical properties. Table B2 also indicates certain identical properties.

Appliances, such as refrigerators and washing machines, are considered "interior" products and are subjected to their own special conditions. A washing machine must be able to resist alkalis in the form of detergents and soaps. Refrigerators must resist grease (butter, lard, Crisco, etc.) and stains, such as tomato and lemon juices, alcohol and mustard. While appliances are not subjected to weather conditions, washing machines, for example, must withstand temperatures ranging from 106° to 160° F (41.1° to 43.3° C). Refrigerators must withstand cold temperatures from within and room temperature from without.

TABLE B1

PHYSICAL PROPERTIES OF AUTOMOBILES AND APPLIANCES

Automobiles	Appliances
gloss retention	same
color	same
smoothness	same
hardness	same
durability and flexibility	same
abrasion	same
adhesion	same
mar resistant	extensibility

TABLE B2

CHEMICAL PROPERTIES OF AUTOMOBILES AND APPLIANCES

Automobiles	Appliances
humidity resistance	same
corrosion and creepage resistance	same
color stability res.	same
thermal shock res.	grease resistance
gasoline "	alkali resistance
weather "	stain resistance

There are many other kinds of interior products with comparable finishes. However, end-use will create distinct needs. Finishes for furniture and boilers are interior, but the requirements and performance are quite different. Expensive furniture requires a finish which will enhance the beauty of the end product. A great deal of time and labor goes into the production of a fine chair or table. The carpenter, therefore, will most likely place greater emphasis on the quality of finish, than on the ability of the finish to resist heat or grease. Where a boiler may require two or three coats of finish, a piece of furniture may need ten or fifteen coats in order to achieve the desired result. The same principle of individuality applies to all interior products, including the finish for shades, pencils, plastics, paper, bathtubs, and venetian blinds. Each product has its own finish requirements. Finishes for furnaces and radiators must be heat resistant and tough; metal furniture must have tough and mar resistant finishes; machine tool finishes must be oil resistant and tough; and coatings for fabrics (rain coats, tobacco pouch, etc.) must be durable and extremely flexible.

The comparison of appliance and automotive finishes leads us to the conclusion that the physical and chemical properties of the two finishes are similar. However, what distinctions do exist are based on end-uses. The sale of a car depends a great deal upon color and gloss. The best advertisement for an automobile is its external appearance; therefore, the manufacturer insists upon a finish that will maintain its gloss and color. R. P. Ericson, assistant technical director of *Pittsburgh Plate Glass Company,* writes that "the exterior performance of the pigments used in automotives is of prime importance and all manufacturers spend a lot of time and money in evaluation of the exterior durability properties of the pigments; with appliances this is not much of a factor . . . "[44] The appliance, up until recently, had a white finish and, while the appearance is always relevant, the consumer is most con-

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[44] Ericson, *loc. cit.*, note 37, *supra*.

cerned with performance. The fluctuations in weather and road conditions subject the car finish to very adverse conditions, thus giving the properties of flexibility and durability special significance. In the case of appliances, resistance to stains and alkalis is of primary importance. The chemical composition of a finish will vary in ingredients or ratio of ingredients according to the specialized needs.

In summary, industrial finishes can be classified as follows:

- INDUSTRIAL
  - exterior
    - end-use
      - substrate
      - technique of drying & application
  - interior
    - end-use
      - substrate
      - technique of drying & application

The basic ingredients of all industrial finishes are the same—solvents, vehicles, and pigments. There may be some variation in specific ingredients, but it is more likely that the distinction will be focused on the ratio of ingredients. Ericson writes the following about automotive and appliance finishes:

> "The basic difference between the ingredients of automotive finishes and those used in appliances . . . are slight and in many cases non-existent. In fact, the ingredients can be identical; however, because they are used for different end purposes, the formulations will vary in the ratios used." [45]

[45] *Ibid.*

In addition, it may be recalled that there are a number of vehicles which produce the same properties when correctly formulated with solvents, pigments and primers. The substitution of one resin for another may change the formulation but, at the same time, produce the same results (see, Lilly list, see D(1), *supra*). The difference in exterior finishes may depend more on the substrate and methods of application and drying than on the ingredients. It would be rather cumbersome and impractical to bake an entire railroad car, as can be accomplished with automotive bodies and parts. Consequently, air-dry type finishes are used for railroad cars. Similarly, the kind of substrate is important in determining the kind of finish to be applied. The manager of the *General Electric* finish-systems laboratory writes the following:

> "I should like to emphasize that the performance of any organic finish, both as to its chemical as well as physical properties, is greatly influenced by the physical and chemical nature of the substrate over which the organic finish is applied. This is true whether the finish is for appliances, automotive or building construction. Too many people do not give sufficient attention to this phase in evaluating and studying organic finishes." [46]

It is reasonable to conclude, therefore, that the major technical difference between automotive and non-automotive finishes is not one of chemical composition but, rather, a distinction in the end-uses, substrates, and application and drying techniques, which may in turn affect the chemical ratios of the basic ingredients.

(3) Evaluation of the Market by the Expert:

It is apparent from this analysis that the distinction between automotive and non-automotive finishes based on the available technical data is neither a decisive nor obvious fact. Quite to the contrary, there is evidence of a technical simi-

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[46] Ralph G. Thompson, Manager of Finish Systems Laboratory of *General Electric*, personal communication of April 21, 1961.

larity. Before proceeding to the expert's evaluation of the market (the final factor under consideration), it might be useful to compare the functional characteristics of the finishes and wrapping markets. The Court, in the *Cellophane* case, recognized the distinctions between the various kinds of flexible wrappings, each having its own functional advantages and disadvantages. However, the Court concluded that there was enough similarity between the flexible wrappings to classify them in the same market category. The finishes market has many of the basic characteristics of the wrapping market. Each finish, depending on its end-use, has certain property distinctions, but all of the finishes are basically the same. An automotive finish has excellent durability, while an appliance finish has good stain resistance. Technically speaking, however, both finishes are very similar. Cellophane has high transparency, while aluminum foil has good printability. Both products, however, are considered flexible wrappings.

The distinction between the relationship of cellophane to its market, and automotive finishes to its market is not one of technical or functional characteristics. The difference in the two product relationships is based on market structure. In the case of cellophane, its users are multifarious, ranging from candy to cigar manufacturers. The use of automotive finishes, however, is restricted to a handful of manufacturers. One might say that a form of oligopoly exists, in the sense that three or four large companies are the sole buyers of automotive finishes. It is at this point in the study that the opinions of experts in the field adopt special significance, because the professionals in the industry best understand the market composition.

Letters were sent to six experts in the field of plastic technology requesting their opinions on two basic questions:

(1) Assuming that organic finishes are composed of solvents, vehicles and pigments, what peculiar characteristics do automotive finishes possess to distinguish them from other industrial finishes?

(2) Based on your own knowledge and experience, would you place automotive finishes in a separate market category? Why?

In answer to question one, I received the following opinions:

(a) Henry Fleming Payne, author of "Organic Coating Technology"—

Mr. Payne listed the following distinguishing characteristics of automotive paints: "(1) lowest cost compatible with performance requirements; (2) fastest possible speed of finishing; (3) necessary exterior durability and excellent appearance and maintenance of appearance on aging; and (4) fool-proof in application so that there will be minimum rejects and no delay on the production line." [47]

(b) Elias Singer, author of "Fundamentals of Paint, Varnish and Lacquer Technology"—

While Mr. Singer did not specifically answer this question, he writes the following in his book: "As might be imagined, these types of lacquers (automotive) represent the highest grade exterior pigmented lacquer. They must be able to retain their gloss over a period of years. They must have excellent adhesion over metal and over non-metal base coats of paint and lacquer." [48]

(c) Dr. Ralph Witt, Associate professor of plastics technology at Johns Hopkins University—

Dr. Witt agrees with Payne as to an answer.

In answer to question two, a more comprehensive response was received:

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[47] Payne, personal communication of July 1, 1961.

[48] Singer, *op. cit.*, note 30, *supra*, p. 164.

(a) R. P. Ericson, Assistant technical director of the research and development center (paint division) of *Pittsburgh Plate Glass Company*—

Mr. Ericson writes the following: "Automotive finishes are placed in a separate market category from industrial finishes chiefly because the automotive industry, where they are used, is compact and centralized to a degree not true of other industrial finishing users. It is a simple matter to concentrate sales efforts for automotive finishes since the customers are large, use large volumes, and are located in a few centers. Industrial finishes as a class are used by a wide variety of companies representing all degrees of volume usage and they are scattered in villages, cities and towns all over the United States and must be solicited on a territorial basis if they are to be solicited at all, in many cases." [49]

(b) Elias Singer—

Mr. Singer writes the following: "We would probably place automotive finishes in a separate category from other industrial finishes in that they require formulations designed specifically for use on automobiles. Since this is a very large volume business, you will find that the manufacturers of automotive finishes are a rather small number who specialized in sales to the automobile manufacturers." [50]

(c) Dr. Ralph Witt—

In a personal interview with Dr. Witt, he expressed the opinion that the market structure was such as to make automotive finishes a distinct market category.[51]

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49 Ericson, *loc. cit.*, note 37, *supra*.

50 Singer, personal communication of June 26, 1961.

51 Personal interview with Dr. Ralph Witt on July 18, 1961.

(d) Henry F. Payne—

Mr. Payne writes the following: "Automotive finishes constitute a separate market category because the concentration of the industry in Detroit makes it difficult for east or west coast manufacturers to compete. Also because of the demanding nature of the specifications and the requirements of minimum cost and maximum performance." [52]

(e) A. F. Mundt, Director of sales at *Lilly Varnish Company*—

Mr. Mundt writes the following: "My personal opinion is that there is no difference in marketing an automotive finish or a so-called industrial finish. Automotive finishes are industrial finishes. From the experience I have had, they are sold in an identical manner to most other industrial finishes. Those persons who are closely connected with the complex automotive field sometimes lose sight of the fact that there is other heavy industry requiring tailormade protective coatings beside the automotive." [53]

(f) Joseph F. Battley, President of the *National Paint, Varnish and Lacquer Association*—

Mr. Battley writes the following: "We consider automotive finishes a separate market category. If one does not have a market with one of the automotive manufacturers, there is no point to producing automotive finishes." [54]

The distinguishing characteristics of automotive finishes may be summarized as follows: (1) a finish with excellent

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[52] Payne, personal communication, *loc. cit.*, note 47, *supra*.

[53] Mundt, personal communication of May 3, 1961.

[54] Joseph F. Battley, President of the *Paint, Varnish and Lacquer Association*, personal communication of June 30, 1961.

color, gloss, and durability; (2) rapid application and drying of the finish; and (3) a finish capable of achieving certain chemical and physical properties at the lowest cost possible. The reason for a lasting finish has already been explained—the sale of a car is significantly affected by its external appearance. The necessity for a fast method of application and drying is based on the speed of production. The manufacturer must meet the demand of the consumers, and the production process must be geared to supply this demand. In 1955, there were 7,942,132 passenger cars and 1,246,442 trucks produced in the United States, as compared with 5,585,000 electric dishwashers, 4,200,000 refrigerators, and 5,702,859 total laundry appliances.[55] The output of the automotive industry far exceeds any of the appliance products. From the supplier side of the market, the gap is even greater. In 1958, 19,413,000 gallons of automotive finishes were produced as opposed to 6,768,000 gallons of appliance finishes—almost three times as much automotive finishes was produced.[56] * The last factor of maximum performance and minimum cost is associated with the second question, which has been affirmed by five of the six experts. Automotive finishes are given a separate market category because of the concentration of its users and the resulting economies of large-scale production. Ericson has pointed out that large investments are made in research to produce pigments that meet the physical requirements of the industry. The same applies to the solvent and vehicle ingredients of the automotive finish. The following paragraphs were written in the *Chemical Week* magazine of March 10, 1956:

> "What do you do when the biggest firm in your field makes a bid to capitalize on a couple of new products—and starts sinking millions into plants to manufacture these new products?

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55 *Paint, Varnish, Lacquer Statistical Handbook*, 1960, pp. 48 and 50.

56 *Ibid.*, p. 9.

* The larger quantity of finishes used by the automotive industry is due, in part, to the larger ratio of surface covered.

> You try to match product for product—and that's what started the hottest fight in 20 years in the $80-million-year automobile finish business.
>
> DuPont, largest supplier of auto paints, touched it off a few weeks ago when it brought out its new Dulux 100 and Lucite finishes . . . Dulux 100 is an alkyd-type synthetic enamel, and it's felt that DuPont, already a prime supplier of lacquer-buying General Motors, is now making its strongest bid for the favor of enamel-buying Ford (which has been making its own paints, as well as buying heavily from Rinshed-Mason). Plainly, it will be a gloves-off fight." [57]

This article clearly indicates that the survival of a firm producing automotive finishes depends quite significantly on two factors: one, its ability to gain a foothold in the sales to one of the major firms; and, second, its ability to maintain its position through technical achievement. The quest for better and cheaper finishes for automobiles necessitates a long-term investment in research. The volume and concentration of automotive production, and the resulting demands made upon the producers of automotive finishes, *ipso facto,* create a separate market.

The peculiar characteristics and uses of automotive fabrics will not be examined in this paper. However, the structure of the automotive industry applies equally to automotive fabrics, regardless of the technical characteristics. Volume and concentration are two features of the automotive industry which must influence the structure of both the automotive finish and fabric industries. Herman H. Fischer of *B. F. Goodrich Company* writes the following:

> "Automotive fabrics are always placed in a separate market category. This is due to the volume of business, the application, the highly competitive situation, and the

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[57] *Chemical Week,* March 10, 1956, pp. 73 and 74.

amount of expediting required (the assembly line cannot go down)."[58]

In retrospect, there are two sides to the issue of the relevant market in the *duPont-General Motors* case: one, the market structure of the automotive industry, and two, the peculiar characteristics and uses of the product (automotive finishes). The latter is measured in qualitative terms and the former, in quantitative terms. Qualitatively, automotive finishes are as much a part of the finishes market as cellophane is of the wrappings market. Similarly, the functional distinction between appliance and automotive finishes is no greater than the difference between cellophane and aluminum foil. In a technical sense, automotive finishes have no significant peculiar characteristics and uses. Quantitatively, the situation is quite different. The small number of sellers of automotive finishes is the result of a concentration of demand on the buyer side of the market. The qualitative findings provide some indication of what the market situation could be like if the demand were adequately diversified. The quantitative findings, in this case, are predominant because of the actual market structure of the automotive industry, creating concentration in the supply side of the market.

IV. The Analytical Technique — Post-1957

The Supreme Court in 1955 fully incorporated the analytical technique in its analysis of the flexible wrappings market. In 1957, the Court substituted the qualitative approach for the quantitative technique by confining its scope of analysis to statistical evidence. The position of the Court, therefore, was made somewhat ambiguous. The question remained as to the role of the analytical technique in market analysis after the *duPont-General Motors* case.

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58 Herman H. Fischer of the *B. F. Goodrich Industrial Products Co.*, personal communication of April 18, 1961.

In an effort to clarify the position of the courts in regard to the analytical technique, an examination will be made of two market decisions concluded within the last five years—*Bethlehem* and *Columbia Pictures;* and the *Brown Shoe* case which is presently before the Supreme Court.

A. *Bethlehem Decision*

United States v. *Bethlehem Steel Corporation* was initiated by the Government and brought before the United States District Court, Southern District of New York in November of 1958. The Government contended that the proposed merger between Bethlehem Steel Corporation and Youngstown Sheet and Tube Company would "substantially lessen competition in the iron and steel industry, as a whole, and in a variety of important products," thus violating Section 7 of the Clayton Act.[59]

Because of the multiplicity of products involved, both the Government and the defense approached the market from two levels. First, the general category of iron and steel was examined. The Government contended that the iron and steel industry was an entity in itself, with sufficient peculiar characteristics and uses to be classified as a separate line of commerce. The defense, on the other hand, argued for a much broader interpretation of the relevant market; included in its definition were substitute products, such as copper and aluminum. The District Court supported the Government's presentation. Judge Weinfeld held that copper and aluminum, based on the tonnage and volume shipments, were not in any "substantial" competitive position with iron and steel.[60] In addition, the Court found that steel was being used "for a great many purposes for which other metals (were) . . . not satisfactory substitutes."[61] Iron and steel had achieved an

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59 *United States* v. *Bethlehem Steel Corporation and the Youngstown Sheet and Tube Company*, 168 F. Supp. 580, 581 (S. D. N. Y., 1958).

60 *United States* v. *Bethlehem Steel Corporation and the Youngstown Sheet & Tube Company, Findings of Fact and Conclusions of Law*, p. 152.

61 *Ibid.*, pp. 152 and 153.

exclusive position in the supply of products for the construction of heavy structures, such as bridges, battleships and powerhouses. In home construction, iron and steel were the predominant materials used in the manufacture of "sanitary drainage . . . , gutters, downspouts, kitchen sinks and kitchen cabinets."[62] The Court concluded that the iron and steel industry was a separate and distinct market category.

The second level of analysis involved an examination of all the major products produced in the iron and steel industry. The Government contended that each of the steel products should be considered a separate market. It was maintained that each of the products possessed peculiar characteristics and uses, as well as substantial price differentials. A distinct market classification was further substantiated by the accepted practices and usages of the trade.[63] The Government subdivided the iron and steel industry into the following products: hot rolled sheets, cold rolled sheets, hot rolled bars, track spikes, buttweld pipes, seamless pipes and tubes, electric weld pipes, and tin plates.[64]

The defense argued for a less articulate division of steel products. According to the defense, there were four major subdivisions: (1) sheet and strip mill products; (2) bar mill products; (3) tin, and (4) pipes. The subdivisions were based on the "production flexibility concept," initiated in 1948 with *United States* v. *Columbia Steel*.[65] The four categories of products were part of a broader category, referred to as the "common finished steel products." All of the common finished products were produced from the same material—ingot. A manufacturer could easily shift production from one category of products to another with a minimum amount of mobilization. Consequently, the defense felt that because all the products were derived from a similar source, they neces-

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[62] *Ibid.*, p. 153.

[63] *United States* v. *Bethlehem Steel Corporation and the Youngstown Sheet & Tube Company*, 168 F. Supp. 589.

[64] *Ibid.*, p. 591.

[65] *Ibid.*

sarily fell into the same market category. The four major subdivisions presented by the defense were based on the contention that each category was subject to the same production operation. In the case of sheet and strip mill products, for example, each product was formed from a rolling process.[66] The defense also argued that substitutes existed for many of the steel products.

The Court made an extensive examination of the production operations of iron and steel, beginning with the mining of raw materials, and concluding with a study of actual production methods and end-uses of the finished products. The District Court rejected the defense's concept of production flexibility. First, it was held that the *Columbia Steel* case was not applicable in the present situation because the former dealt with vertical integration while the latter was concerned with horizontal integration.[*] Second, the defense failed to adopt a consistent position in regard to product classification, and shifted emphasis from the concept of production flexibility to the concept of product substitution. Third, production flexibility did not imply buyer flexibility. As Judge Weinfeld expressed it, "Any definition of line of commerce which ignores the buyers and focuses on what the sellers do, or theoretically can do, is not meaningful."[67] Finally, the Court held that the production flexibility concept was pure theory without any factual substantiation. In the words of the Court, "In practice, steel producers have not been quick to shift from product to product in response to demand."[68]

The Court then went on to examine each one of the relevant products for peculiar characteristics and uses, and possible substitutes. It was found, for example, that while both cold and hot rolled sheets were used for automotive production, the former was superior for exterior surfaces requiring smooth

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[66] *Ibid.*, p. 590.

[*] The DuPont decision of 1957 extended the scope of Section 7 of the Clayton Act to cases involving vertical integration.

[67] *Ibid.*, p. 592.

[68] *Ibid.*

and glossy finishes, and the latter was utilized for frame sections and pans. Hot rolled sheets were less expensive than cold rolled sheets, but both were substantially less expensive and more extensively used in automotive production than aluminum or copper sheets. A similar procedure was followed for all the relevant products. The Court concluded that the various kinds of sheets, bars, spikes and pipes formed distinct markets, each with its own characteristics and uses. The Court stated that " . . . each (product) has unique physical characteristics, . . . different end uses, and is recognized by steel producers and consumers as a distinct product. Each has its own competitive standard and markets."[69] The market subdivisions, as presented by the Government, were adopted by the Court.

In retrospect, the Court fully utilized the analytical techniques in its study of the iron and steel industry. First, a thorough examination was made of the end-uses for all the products in question. It was found, for example, that hot and cold sheets were used in automotive and appliance production, buttweld pipes were utilized for plumbing and heating, electric weld pipes served in the capacity of pipe lines, and seamless pipes were used for the drilling and extraction of oil. Second, the Court relied on the opinions of manufacturers and consumers in evaluating the generally recognized market.

The Court diverged somewhat from the procedure followed in the *Cellophane* case with its examination of the concepts of product substitution and production flexibility. The measurement of substitution was not based on a concept of cross-elasticity of demand, but rather on a quantitative and technical analysis of the products in question, the latter being an integral part of the analytical technique. The Court observed that in certain industries, copper and aluminum products were inadequate substitutes. Iron and steel maintained a major stronghold on the market for heavy construction prod-

[69] *Ibid.*, p. 593.

ucts because there were no other materials capable of fulfilling the demands and requirements of the industry. The automotive industry, for example, relied on iron and steel products because of their physical superiority and relative cost. In other areas, where there was no indication of technical superiority, the Court found that, in quantitative terms, there were no substitutes for iron and steel. Measurement was based on percentage production, percentage changes in production, and tonnage shipments. The Court found, for example, that there were no "effective substitutes for the predominant uses of any of the types of steel pipes." [70] The relationship between price change and sales was not examined. It was implied that the technical and quantitative factors were adequate indicators of the existence of substitute products.

The Court, in rejecting the concept of production flexibility, had supplanted rather than supplemented the characteristic technique with the analysis of end-uses. However, the Court did examine the entire production operation, a procedure not alien to the courts. The *Alcoa* and *Cellophane* decisions contained a rather comprehensive study of production operations. The Court, in the *Cellophane* case, even went so far as to observe the actual running operations of a wrapping plant.

Generally speaking, the *Bethlehem* decision further solidified the position of the Court in regard to the analytical technique. Except for the exclusion of cross-elasticity measures, the Court fully utilized the analytical processes.

B. *Columbia Pictures Decision*

In June of 1960, the United States brought civil suit against *Columbia Pictures Corporation, Screen Gems,* and *Universal Pictures Company* for violation of the Sherman and Clayton Acts. The Government contended that an agreement between Universal and Screen Gems (a subsidiary of Columbia) pro-

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70 *Ibid.*, note 35, *supra.*

vided the latter with a fourteen-year control over the distribution of six hundred feature films for television exhibition was illegal.

The Government argued that the relevant market was limited to feature films for television. The defense contended that the scope of the market included other films and television programs. The Court held that the relevant market encompassed a variety of forms of television entertainment, including wiretapped performances, live shows, cartoons, and shorts. In examining the relevant market, the Court held that a number of factors had to be considered in any market analysis, including the means by which products were marketed, the physical characteristics and prices of the products in question, and cross-elasticity of demand.*

The Court emphasized the importance of "evidentiary matters" as supplemental to statistical evidence. In the Court's opinion, "Statistics dealing with only rank and percentages do not by themselves suffice to describe whether the vigor of competition has been affected." [71] The importance of the analytical technique in the Court's examination was revealed in the following statement:

> "Type of proof offered by the Government on this issue disregards or overlooks the following factors: competition afforded by other types of television programming; the advent of Videotape; the economic strength of buyers; the extent of the need for feature films; the quality of feature films held by Screen Gems as compared with those held by others; the availability of new unshown feature films which will or may soon be available; the fact that the product being distributed is of a diminishing character; the circumstance that a high position in one year does not insure that this position will be main-

* The Court distinguished price sensitivity, substitution, and cross-elasticity. (189 F. Supp. 185.) In effect, they are all one and the same thing.

71 *United States* v. *Columbia Pictures Corporation*, 189 F. Supp. 196 (S. D. N. Y., June 29, 1960).

> tained in future years (no large capital investment is necessary); and the imminent release to television of post-'48 feature films." [72]

The District Court made its position very clear—any market decision must be based on a factual examination of actual market conditions. Once again, the Court gave further support to the analytical concept.

C. *Brown Shoe Decision*[73]

One of the most recent antitrust actions involving the issue of relevant market is now before the courts. The United States has brought civil suit against the Kinney and Brown shoe companies to inhibit a proposed merger between the two companies. The controversy centers around the definition of "peculiar characteristics and uses." The Government contends that the only practical definition of the market necessitates a broader interpretation. According to the Government, shoes are a distinct market category, properly subdivided into men's, women's and children's shoes. The defendant's definition calls for a narrower concept based on existing company product classification and price differential. It is argued that the Government's definition incorrectly assumes product interchangeability. The defendants contend that no such interchangeability exists because of price and quality variation.

The issues in the *Brown Shoe* cases are complicated by semantics, but the fundamental question remains the same—on what basis should the market be defined. In the *Cellophane* case, the wrapping materials varied in quality and price but maintained similar end-uses; in this decision, end-use was the determining factor. In the *duPont-General Motors* case, automotive and industrial finishes were given separate market status because of their "peculiar characteristics and uses." The actual basis for market determination, however, was the

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72 *Ibid.*

73 179 Fed. Supp. 721.

market structure evaluated in quantitative terms. The *Bethlehem* case presented another unique combination of products with different physical characteristics and varied end-uses. The overall market definition was primarily based on quantitative analysis and the observations of experts and manufacturers. All of the decisions were concerned with the question of limiting the market to products with peculiar characteristics and uses. The Court's emphasis has varied from case to case but the overall techniques have remained unchanged. Similarly, the definition of the relevant market in the *Brown Shoe* case depends upon product classification. The Court must decide whether shoes should be categorized according to style, quality, price, method of production, method of marketing, geographic area or general usages. The analytical technique will be the primary tool in the Court's examination of the market.

V. Summary

The period from 1953 to the present witnessed the full development of the analytical technique as the basic approach to market analysis by the courts. Each of the cases examined in this paper served as a stepping stone in the application of the analytical technique to market analysis. *Times-Picayune* initiated the analytical approach with the Court's recognition of a possible market composition of products with diverse physical characteristics. The *Cellophane* case represented the first complete application of the analytical technique, with the utilization of cross-elasticity, technical and quality analysis, end-uses, and market evaluation by producers and experts. The *duPont-General Motors* decision was important for a number of reasons. It was the first important Supreme Court case involving the question of the relevant market to succeed the *Cellophane* case. Second, the Court coined a phrase which was to serve as the legal title of the analytical technique—"peculiar characteristics and uses." Third, the Court, by failing to fully elaborate on the peculiar characteristics and uses of automotive finishes and fabrics, relied primarily on

statistical evidence. The Court was justified in distinguishing automotive finishes on the basis of market structure; however, the Court was not justified in assigning automotive finishes peculiar characteristics or usages without a technical examination of the products. The position of the Court had to be substantiated on the basis of facts and evidence. The question of the relevant market was not examined by either the lower court, the plaintiff or the defense. It was therefore incumbent upon the Court to present a thorough and detailed examination of the available evidence.

The ***Bethlehem Steel, Columbia Pictures,*** and ***Brown Shoe*** cases further substantiated the position of the Court in regard to the analytical technique. In ***United States*** v. ***Bethlehem,*** the Court applied both substantive evidence and statistical data. Practically every aspect of the market was examined: raw materials, production operation, end-uses, prices, output, quality (technical analysis), and expert opinion. The findings were complete and conclusive. The ***Columbia Pictures*** case did not necessitate such a detailed analysis because of the absence of any production operation. However, the Court disapproved of statistical data as the sole or primary evidence in the determination of market competition. The Court reviewed the role of the analytical tools in market analysis, and concluded that the evidential material arising out of their application was of particular relevance. The ***Brown Shoe*** case presented a recent study of the market. The analytical techniques initiated in ***Times-Picayune,*** applied in the ***Cellophane*** case, and titled in the ***DuPont-General Motors*** case, have been fully integrated into the judicial processes as a primary tool of market analysis.

STIPULATIONS OF FACT: THE POSSIBILITIES FOR THEIR GREATER USE*

by

TERENCE H. BENBOW**

In an antitrust group such as this I am sure that it is unnecessary to belabor the burdens which are involved in Sherman Act litigation—and particularly the burdens of proof. It is necessary, however, to allude to these burdens in order to put the subject of current development which I have been asked to introduce into proper perspective. With the growing activity in the Sherman Act field, both private and governmental, these burdens might threaten to overwhelm us unless we can take constructive new approaches to this most protracted of all litigation. As stated only last year by the Court of Appeals for the Ninth Circuit in *Chronicle Publishing Co.* v. *National Broadcasting Co.*,[1] "If the mechanics of justice are not to be wholly overwhelmed by the steadily increasing burden of complex antitrust litigation, means must be found for easing that burden." And as Gerry Gesell said to this group last year: "I believe more would be gained were we to spend time on procedural matters, in an effort to find better ways of determining facts in these complex cases."[2]

In reviewing last year's program I was struck by the fact that a part of the program was described as "talks on a variety of timely subjects by attorneys who 'were there!'" Based on a recent case where I "was there," one such constructive approach would seem to me to be a more extensive use of stipulations of fact. This is certainly an approach

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* Address before the Antitrust Law Section of the New York State Bar Association—January 24, 1962.

** Winthrop, Stimson, Putnam & Roberts.

1 294 F. 2d 744, 747 (9th Cir. 1961).

2 CCH 1961 *Antitrust Law Symposium* 98.

which should have the support of every lawyer who is interested in reducing the burdens of proof in Sherman Act cases. And I am not thinking of cases where there is little dispute as to the facts, situations in which a stipulation is the obvious solution. Many of the matters of proof in all Sherman Act cases are non-controversial or are at least capable of some form of stipulation. It may be fruitful therefore to inquire into the problems as to stipulations of fact—the reasons why such stipulations are not more common and what techniques might facilitate their use.

Frankly stated, the major stumbling block to more common use of stipulations would seem to me to be the hesitancy of lawyers to commit themselves to a factual position. Many of us fear that when we study the facts further we may find implications in them that we did not recognize at first. As long as we have not admitted what the facts are we remain free to urge an interpretation of the facts consistent with our fresh insights.

This reluctance, as well as the advantages of admissions of fact over interrogatories when admissions of specific matters are sought, is well stated in the English case of *Clarke v. Clarke*,[3] quoted more fully in Professor Moore's[4] discussion of Rule 36 of the Federal Rules of Civil Procedure:

> "As regards admissions of fact, it is often urged, as it was here, that a litigant will hesitate to state on oath what he will without hesitation state in pleadings, and that there is difficulty in otherwise obtaining admission of facts, even though not really in dispute; and it is further urged that an admission by an affidavit in answer to interrogatories is useful in limiting the issues to be tried, and therefore in reducing the time occupied by the trial and the costs. I recognize the importance of this in the abstract; but practically I find that the interrogated party seldom makes such clean admissions as secure the ad-

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[3] (1899) W N 130.

[4] 4 *Moore's Federal Practice* 2706.

vantages aimed at, and, failing that, little if anything is gained. As regards facts not really in dispute, I believe that the power of requiring admissions is not sufficiently used."

But then the Court immediately goes on to assert:

"If parties insist, as they generally do, on asking their opponents to admit as facts, dates and events about which there is room for doubt or argument, of course the endeavor to obtain admissions breaks down; but if the demand is limited to facts not really in dispute, that is, which can be admitted cleanly, or subject to some simple qualification, I find that it is generally acceded to, and the power which the Court has of throwing the costs on anyone who has increased them by declining reasonable admissions is not forgotten."

As far as stipulations are concerned, my recent experience would not agree with *Clarke* v. *Clarke* and Professor Moore that asking opponents to admit as facts, dates and events about which there is room for doubt or argument means the endeavor to obtain admissions will break down. The reluctance to become "frozen in a position" is a difficult stumbling block to overcome and one which, it seems to me, will always act as the outer limitation on the extent to which stipulations of fact are used. The limitation, however, often never comes into play because of the failure even to try to initiate a stipulation. When it does come into play, recent cases illustrate that the limitation can be overcome if lawyers will allow themselves and their opponents the opportunity and time to resolve their lingering doubts. As stated last July by Chief Judge Ryan in *Baltimore and Ohio Railroad Co.* v. *New York, New Haven and Hartford Railroad Co.,*[5] "We have before us *as a result of extended pretrial hearings* a rather voluminous and complete statement of agreed and undisputed facts."

[5] 196 F. Supp. 724, 726 (S. D. N. Y. 1961) (emphasis supplied).

The recent case where I "was there" was brought by the Government. One of the parties, therefore, was not under the obligation pointed to in *Clarke* v. *Clarke* to stipulate to incontrovertible facts or have to pay the expenses of proof.[6] The facts were very much in dispute. Yet the stipulation comprehended most of the central issues in the case and ran to 149 paragraphs with 430 exhibits. Work on it commenced eleven months after the suit was brought following a series of pretrial conferences, the answering of defendant's interrogatories and the deposition of one of defendant's employees. At the suggestion of the Court, the plaintiff first offered proposed items for agreement. Then the defendant offered proposed items, which included the plaintiff's items insofar as they were acceptable and additional matters which defendant wished to have stipulated. These items were in turn reviewed and amended by plaintiff.

When it developed that one side was unable to get the other to agree to the truth of a particular statement of facts, the technique was successfully employed several times of stipulating that, if called to testify, witnesses would state under oath that the facts were as stated. The stipulation was negotiated and signed in five separate parts over a period of five months. In order that you can trace the progress, 129 paragraphs with 24 exhibits were signed in less than three months. Another 11 most controversial and detailed paragraphs with 61 exhibits took another three weeks to sign. Another paragraph was signed nearly three weeks thereafter. Four more paragraphs took another three weeks; the final four paragraphs of the most detailed character with 345 exhibits were signed three days later.

I think the pattern is clear from the figures. The most progress was made in the earlier period. The more controversial and more detailed subject matter with the most exhibits, particularly exhibits which were prepared especially for the stipulation, took the longest time and was the hardest

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6 Federal Rules of Civil Procedure, Rule 37(c) and (f).

to stipulate. Yet even these stipulations must be measured against the burdens which their proof at trial would have entailed. Obviously, such burdens cannot be measured in trial time alone, but must also be measured by the time and effort necessary to be ready to offer or contest their proof at trial. Considering these burdens and also the time and effort which had already been expended during the first three months before isolating the more controversial and detailed items, my own opinion is that the additional two months resulted in an ultimate saving in time and energy. In that regard, it is important to point out that the trial commenced two days after the signing of the final stipulation and was over in less than two months. The case should be decided by the trial court only a little over two years after the complaint was filed—any time now.

Because of the advantages of such stipulations in reducing the burdens of proof, I am convinced that if we should adopt the technique of experimenting with stipulations as a matter of course in Sherman Act cases contested on their facts, it would be a major step in their greater use.

The stipulation in this recent case had the advantage that it settled the truth of the stipulated facts once and for all. The stipulation covered not only the action itself but any new trial or retrial or any trial arising out of the conduct complained of in the action. Each party, however, reserved the right to object to the introduction into evidence of any part of the facts on the grounds of relevancy or materiality and the right to introduce further evidence not inconsistent with those facts at the trial. What actually happened was that all of the stipulation was offered at the trial, some of it was objected to and none of it was excluded.

Going to the substance of the case, what kind of matters was it possible to agree on? First of all, the matters of agreement might be divided into eleven general categories as follows: background, cross-license agreements, patent assignments, enforcement, machines of one grouping by place of

origin, machines of another grouping by place of origin, machines of the defendant, the defendant's patents, a large retailer of machines, terms used in the trade to describe machines, and advertising and pricing.

Secondly, breaking down these eleven categories will show how much of the case it was possible to stipulate and how time consuming some of the matters would have been to prove or contest:

1. Even the background contained little that was uncontested other than a statement of the parties involved and the positions or occupations of persons mentioned in the stipulation and documents. The background included definitions of various machines, use of skill in the operation of a machine, the defendant's operations and business, firms that had ceased manufacturing operations, early machines, later machines, first imported machines, development of defendant's machines and introduction of certain machines into the United States.

2. Three cross-license agreements were included and the history and negotiation of each was covered in detail.

3. Three patent assignments were included and the history and negotiation of one was covered in detail.

4. Enforcement was described as to the action taken and not taken with respect to the defendant's patents.

5. and 6. The machines of each of the two groupings by place of origin were described as to the importers, assemblers and distributors, the manufacturers, the methods of distribution, which machines infringed and which machines did not, and the imports of machines in totals and by particular models.

7. Five of defendant's machines were described in most of the following particulars: their development, description, designation, manufacture and sale here and abroad, coverage by patents, expense in research, development, tooling and advertising and price; and the sales of each of defendant's

machines in one category, including the five above, were given by style and year.

8. Five of the defendant's patents were described in many of the following particulars: filing date, interference, date of assignment, date of issuance, validity, elements, machines that infringe and machines that do not, applications or patents in foreign countries, date of reissue application, date of reissue and claims allowed.

9. A large retailer of machines was described as to its license agreement, royalty payments and two of its machines.

10. Terms used in the trade to describe machines included detailed definitions of those used in publications.

11. Advertising and pricing included dozens of advertisements and prices for a very large number of machines and general and specific facts relating to these subjects.

As you can see, the kind of matters which it was possible to agree on—and all in one case very much contested on its facts—was about as broad as one could wish. Many of them went to the crux of the case.

Perhaps of all the stipulations those which demonstrate best the possibilities for saving the time and energy of Sherman Act court and counsel are the agreements as to which machines infringed and which machines did not infringe the patents. In patent cases, where infringement may be the ultimate question, whether a single machine infringes a single patent is often properly the principal subject of a lengthy and difficult trial. On the other hand, in a Sherman Act case infringement status, no matter how vital, is not the ultimate question. The saving in having stipulated, for example, that fifteen machines of four different types did not infringe one of the patents, illustrates the dramatic possibilities which experimenting with stipulations affords for cutting down the length and burden of Sherman Act trials.

A practical test, and the last one I will offer you of the usefulness of the stipulations, was their effects in terms of

the proposed findings of fact. Plaintiff and defendant each relied on the stipulation for over half of the more than 250 and 300 findings respectively proposed by them. Many of the proposed findings on both sides relied exclusively on the stipulation. Between the two sides, almost every one of the 149 stipulated paragraphs were entirely included in the proposed findings. The exhibits to the stipulation, including those which were prepared especially for the stipulation, also played a major role in the findings proposed. There can be no question but that in the findings and throughout the case the burden of both counsel and the court was lightened by the fact that there was a substantial body of material as to which the parties had agreed.

The question which this introduction is intended to raise is simply whether stipulations of fact may not be capable of some application with similar benefits in your own Sherman Act cases.

COMPUTERS: ANTITRUST, PATENT AND COPYRIGHT LAW IMPLICATIONS*

by

Arthur H. Seidel**

I am appearing before you this afternoon in the guise of either a prophet or expert. The definition that fits either prophet or expert under these circumstances is that the party charged with such offense is delivering an oration more than 100 miles from his home. In fact, there are those who would measure the degree of expertise in direct proportion to the distance between the speaker's home and the place of the address. Since my home in Philadelphia is many hundreds of miles from Chicago, I suppose I qualify as something in the way of a prophet or an expert or both by that definition.

I am also appearing before you as a patent attorney. Now patent attorneys have been categorized as being "lawyers" by engineers, and "engineers" by lawyers. There are many times that I am certain that I am neither.

The implications of computer technology in my specialty are literally enormous. I shall address my remarks to broad areas in the antitrust, patent, trademark, and copyright law in that order.

In the field of antitrust law the most obvious possibilities for problems arise from violations of Section 1 of the Sherman Act. Section 1 provides in substance that:

> "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations,

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* Speech delivered to Forum on computers sponsored by Joint Committee on Legal Education of American Law Institute and American Bar Association at Chicago, Ill. on Oct. 20, 1961, reprinted with permission from the Journal of the Patent Society (February, 1962).

** Patent attorney, Philadelphia, Pa.

> is hereby declared to be illegal . . . every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a misdemeanor."

You will note that the language is "contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce."

What is the effect of two or more competitors adopting simultaneous programming techniques for prices, production, production controls, standards, technical data?

What is the extent of conspiracy and conscious parallelism which must be demonstrated before a violation may be established?

You will all recall the *Maple Flooring Mfg. Association* v. *United States,* 268 U. S. 563 (1925) in which the Supreme Court held that where a trade association disseminated statistics on average production costs of the members, the distribution of a freight rate book, the dissemination of composite data on sales, past prices, and inventories, and a general discussion of market factors and conditions at monthly association meetings, that this was not a violation of Section 1. What would the Supreme Court feel about the infinitely more detailed statistics and information, *and conclusions* which could be made available to an industry through a trade association by the use of computer technology?

Again in the case of the *Cement Manufacturers Protective Association* v. *United States,* 268 U. S. 588 (1925), the Supreme Court upheld under Section 1, the interchange of information among sellers concerning the duplication of specific job contracts. How would the Supreme Court view the large mass of accurate conclusionary material which could be derived from computer programming?

One must not forget either *Sugar Institute, Inc.* v. *United States,* 297 U. S. 553 (1936) in which a trade association plan involving the requirement that the association's members

announce prices and adhere to them without discrimination was a violation, or the *Federal Trade Commission* v. *Cement Institute,* 333 U. S. 683 (1948) in which a multiple basing point plan of price quotation was held to violate Section 5 of the Federal Trade Commission Act by violating Section 1 of the Sherman Act.

What I am saying probably resolves itself to this:

Does not the computer with its ability of handling enormous amounts of variables and arriving at conclusions whose accuracy could not heretofore be attained permit conscious parallelism even in the absence of a direct contract or conspiracy, and therefore does not the computer render many cooperative industrial approaches vulnerable to the charge that they constitute a combination "in the form of trust or otherwise"? It is an interesting question. I regret to say that like most of the other questions which I shall pose to you this afternoon, I do not know the answer to it.

Section 2 of the Sherman Act provides in substance that:

> "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor."

Now the real problem with Section 2 violations vis-à-vis the computer as I see it is the question of deliberateness or purpose to monopolize. Assuming that the maxim of "monopoly in the concrete" as stated in *Standard Oil Co. of New Jersey* v. *United States,* 221 U. S. 1, 62 (1911) does not by itself prove the offense of monopolization is still good law, what does reliance upon the computer reveal in connection with a "specific" intent to monopolize?

Is the computer to be treated as one more element such as ability, research, economic operation, etc. which make the dominance of a company within a given industry lawful, or is

the computer to be considered an evil weapon lending itself for the special purposes of the very wealthy and the very powerful?

In short, does the computer fall within Judge Wyzanski's classical example in *United States* v. *United Shoe Machinery Corp.*, 110 F. Supp. 295, 342 (D. Mass. 1953), affirmed per curiam 347 U. S. 521 (1954):

> "The defendant may escape statutory liability if it bears the burden of proving that it owes its monopoly solely to superior skill, superior products, natural advantages (including accessibility to raw materials or markets), economic or technological efficiency (including scientific research), low margins of profit maintained permanently and without discrimination, or licenses conferred by, and used within, the limits of law (including patents on one's own inventions, or franchises granted directly to the enterprise by a public authority)."

How will computer technology affect alleged discrimination in price or terms of sale under Section 2 of the Clayton Act? I believe that in respect to charges of discrimination in price that the computer will offer an objective justification for the price differential which may qualify the defendant for relief under the defensive provisos of Sections 2(a) and (b). Thus, proof as to cost-savings are now objectively possible. The many complexities in proving such matters involving considerations of manufacturing economies, sales techniques, delivery policies, etc. can be handled by a computer with a minimum degree of effort whereas heretofore a mammoth expenditure of expert effort was required.

Above all else the "good faith" meeting of competitive prices pursuant to Section 2(b) may now be objectively demonstrated.

In connection with Robonson-Patman Act defenses, the computer enables objective data to be brought forward regarding the compensation for distributive services. Whether a

given graduated discount system with specified percentage reductions to wholesalers, jobbers and retailers in diminishing amounts is justifiable can now perhaps be objectively determined.

The computer may enable the whole concept of delivered pricing to be reevaluated. The Supreme Court has squarely stated in the *Theater Enterprises Inc.* v. *Paramount Film Distributing Corp.*, 346 U. S. 537 (1954) that "business behavior" was certainly "admissible circumstantial evidence from which the fact finder may infer agreement" in respect to a conspiracy. Since the nub of delivered pricing violations is conspiracy and collusive price stabilization, the computer with its objective determination now renders salutary delivered pricing programs to be deemed clearly lawful.

No discussion of the antitrust laws and computer technology would be complete without a discussion of the effect of the antitrust laws on the machines themselves. The computers as machines raise certain clear antitrust implications. The most obvious of these include:

The sale of standard machine programs to competitors.

The restriction on the sale by the manufacturer of machines specifically designed to meet a given industry's purposes or a given customer's purposes.

Restrictions on the availability of special programs.

In the light of the many decisions on tie-in cases, boycotts, discrimination, etc., I believe that these antitrust implications can be satisfactorily solved.

Before leaving the subject of the antitrust laws, in order to demonstrate that the use of computers in this field is not a theoretical matter, I would like to quote a bit from an article by William M. Beecher which appeared on page 1 of the October 10, 1961 issue of the Wall Street Journal entitled "Justice Department Enlists Computers in War on Price-Rigging." This article carried the subtitle "Machines to Seek Patterns in Identical Bids on Local, State, Federal Business."

The first few paragraphs of the article set the tone for the story:

> "Justice Department Anti-trusters are throwing electronic detectives into their war on price-rigging.
>
> "Giant computers soon will be turned loose to scrutinize thousands of sealed bids which, on being opened by Federal, state and local governments, turned out to be identical to those of competitors. By sifting such bids through the computers, the sleuths hope to spot patterns suggesting possible price-fixing. They'll watch, for instance, the frequency with which individual companies offer precisely the same price as competitors.
>
> "The computers' findings will be screened by anti-trust lawyers and economists, and any resulting leads that seem promising will be handed to FBI agents and Federal Grand Juries for exhaustive investigation."

The patent law will shortly face computer spawned inventions. As the arts become classified and subject to searching by computers, beyond question computers will be used to develop leads and open up new horizons. The obvious area in which this will first be developed is in the field of chemistry. Thus, in addition to searching in order to determine whether or not a given compound has been described in the literature, computers may be used to determine the gaps or holes in the literature. For example, the field of steroid chemistry has been "computerized." A knowledgeable worker in this field with the aid of a computer can determine, by the use of the computer, compounds which have never been synthesized nor described in the literature. In many cases, just this information alone will be adequate to lead skilled workers in the art to the synthesis of the missing compound.

Steroid inventions will undoubtedly be derived from the ability of the computer to correlate enormous amounts of data. Inventions based on the correlation of enormous amounts of

data may frequently be the most complex and most difficult to invalidate on the basis of the prior art.

What the effect of computers will be on the established principles of patentability will be most difficult to determine. Anyone considering this question should not lose sight of the last sentence in 35 U. S. C. 103:

> "Patentability shall not be measured by the manner in which the invention was made."

Computers may of course be used to ascertain the presence of invention. Obvious uses to which computers may be put constitute preliminary searches to determine the presence of invention before the filing of a patent application, searches by the examining corps of the Patent Office, and validity searches in litigation.

A more esoteric but none the less highly fruitful use to which computers may be put in the patent law is in the determination of infringement questions. Very difficult problems from the deceptively simple question as to the equivalency between two means, or between two procedural steps, or between two compositions can be readily resolved through the intelligent use of computers. Thus, computers can cut across entire prior arts.

A few examples will suffice.

In certain environments one particular structure may be the equivalent of another, whereas in others the two are not equivalent. Computers can demonstrate analogies and set forth objective criteria for determining equivalency. This will be a salutary result in the patent law since the question of equivalency in infringement determinations is among the most difficult of problems in the patent law.

Simple examples from the fields of chemistry will suffice. In almost all simple compounds, potassium and sodium may be regarded as equivalent to each other since salts of these elements will normally possess similar properties. However,

in the field of soaps the substitution of sodium for potassium or vice versa will result in a profound effect on the property of the soap. Similarly, under most circumstances manganese would never be construed by a chemist as an equivalent to magnesium. However, with certain welding electrodes, the two are equivalent to each other.

The question of equivalency is no less difficult in validity determinations than in infringement determinations. The computer may make it possible for an objective evaluation of non-equivalency. I submit as a very interesting proposition the following:

Should the failure of a computer to equate two alternatives in a well-programmed art be construed as an objective determination of the absence of equivalency?

I realize that this may lead to judicial determination by machine and the obsoleting of our federal judiciary. However, I submit that there may be more validity in the determination of a well-programmed machine on the question of equivalency than the determination of a non-technically trained lawyer who has no familiarity with the arts in question but is called upon to decide the difficult question of equivalency by virtue of his office as a federal judge.

What about the patentability of programming techniques and the Boolean algebra equation for a logic circuit?

I regret to say that in all probability neither of these will prove patentable, at least under the present state of the law. It is well settled that plans of action are not comprehended within the subject matter of the patent statutes nor are systems involving mental operations. Calculations are clearly not patentable, see *Supermold Corporation of America* v. *American Tire Machinery Co.,* 27 F. Supp. 385 (D. Cal.), affirmed: 114 F. 2d 759 (9th Cir.). Unfortunately, our system rewards the means by which an idea may be made practically useful, but generally speaking the idea itself is not patentable, however new and useful, or even revolutionary and beneficial to humanity that it may be.

A brief word about the use of computers in the United States Patent Office at this time. As I have heretofore indicated, the steroid chemistry art has been classified for computer searching. More recently, the organic phosphorous compounds have likewise been classified.

Lest the value of computer searching be unduly emphasized, I would like to point out that computers have definitely not obsoleted human patent examiners. Computers cannot be made to combine references to anticipate specific inventions, although this would not appear to be insuperable. At the present time, there is no adequate approach towards the searching of mechanical inventions. I think it is self-evident that the searching of the chemical arts is a relatively easy matter compared to the searching of drawings. The underlying skeletal nature of chemical inventions, and their classification into well-recognized groupings render their searching a relatively simple matter. This is not true of mechanical inventions and in particular, complex mechanisms.

A few words about the effect of computers on the trademark law. I believe that if properly handled, the computer can have a profound effect upon the law of trademarks. Now for the first time searches may be made using phonetic equivalents. The great speed of computer researching enables a far deeper delving into technical trademarks than has heretofore been possible by search systems which are wholly dependent upon alphabetical classification.

Indeed, as with the patent law, there is the distinct possibility that computers may be used to objectively determine confusing similarity. I do not believe that it is too far fetched to envision the situation where the acceptance or rejection of a mark by a computer will be determinative as to their similarity. I am of course confining my remarks to situations in which there is no serious problem relating to differences in goods. Where there are serious problems in differences in goods compared to differences in word marks, then the value of computer determinations of confusing simi-

larity becomes minimized. However, one would not want to eliminate humans from the field of trademark law entirely, would one? After all, those of us who specialize in this field (your speaker included) have to make a living also.

In the field of copyrights, a number of interesting problems are present. Are programs copyrightable subject matter, and if they are how may they properly carry a copyright notice?

By analogy to perforated music rolls, and the Supreme Court decision in *White-Smith Music Publishing Co.* v. *Apollo Co.,* 209 U. S. 1, 52 L. Ed. 1086, 28 S. Ct. 722, I believe that both perforated card programs and magnetic tape programs are not "copies" within the meaning of the copyright law. Our law has held that unless a record can be read or visually interpreted, it is wholly incapable of any utility aside from its use as part of a machine specially adapted for using it, and as such is not a substitute for the writings called for in the copyright clause of Article I, Section 8 of the Constitution.

However, our copyright statute, like our other branches of the law, is a vital living thing. Section 1(e), recognizing the deficiency in the copyright law, provides for the control of parts of instruments serving to mechanically reproduce musical works. I see no reason why an enlightened Congress cannot extend statutory protection to computer programs, at least indirectly.

The question of the carrying of the copyright notice on computer programs can also be resolved. Only recently it was resolved in respect to fabrics, where there is a real problem because of the destruction of the copyright notice upon the formation of a garment. There is no reason why the provisions of the copyright statute concerning notice cannot be amended to cover all types of computer programs.

Most certainly the principles of common law copyright and of unfair competition can be extended to protect computer programs. The law of trade secrets is clearly available in respect to computer data. I see no reason for any

change in the existing law of trade secrets to cover the misappropriation of computer programs or data. This is intellectual property, just as is any other trade secret, and should be equally entitled to protection.

A few words about the broadening of the services which may be rendered by the Register of Copyrights in the future by virtue of the advent of computer technology.

I envision the possibility of the maintenance of a library of characters and stock situations. I envision that this may lead to a change in the nature of the defense of invalidity in copyright infringement actions. Perhaps the availability of this data may lead to a closer simulation of the patent system. In view of the catastrophic effects of judge-rendered standards of patentability, this is not something to be looked forward to. However, it is a distinct possibility.

We may some day see searches in the nature of information retrieval to determine the presence of originality in copyrighted works. As I have just stated, I do not look forward to this but it may be just over the horizon.

We are on a new frontier. The patent and copyright statutes go back to 1790, the trademark statute to 1870, and the Sherman Antitrust Act to 1890 (I realize that profound changes have been made in these statutes with the passage of years, so much so that in the case of the law of patents, of trademarks, and of copyrights, the original enactments are almost invisible). With this history of legislative adjustment, I do not fear that the law will rise and come to grips with the computer.

INTERNATIONAL ANTITRUST LANDMARKS: CONSENT DECREES IN THE OIL CARTEL CASE*

by

JAMES T. HAIGHT**

Consent decrees were entered in Federal District Court in New York on November 14, 1960, against Standard Oil Company (New Jersey) and Gulf Oil Corporation.[1] The decrees, ending a seven-year antitrust suit against the two companies, are the most significant development in the interpretation of the application of U. S. antitrust laws to international business during the past five years.

The policies reflected in the decrees represent the first real effort of the U. S. Government to fit the antitrust laws to the variety of every-day business, economic and political problems faced by American companies in international operations.

1. Background of the Case

A secret staff study by the FTC in 1951 alleged that the world oil business was under the control of five American companies and three foreign companies. The Department of Justice originally filed a criminal case under the Truman administration, but the suit was changed to a civil action in 1953, and moved from Washington, D. C. to New York.[2] The complaint alleged that the defendants conspired to control foreign production and supplies of oil, regulated U. S. imports, and divided foreign producing and market territories.

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* Reprinted with permission from the 5 *International and Comparative Law Bulletin* 26 (1961).

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1 *U. S.* v. *Standard Oil Co. (New Jersey)*, 1960 Trade Cases Par. 69,849 (S. D. N. Y. 1960); *U. S.* v. *Gulf Oil Corp.*, 1960 Trade Cases Par. 69,851 (S. D. N. Y. 1960).

2 D. J. Case No. 1163, *U. S.* v. *Standard Oil Co. (N. J.) et al.*, Civil Action No. 1779-53. U. S. D. C. for D. C.; Civil Action No. 86-27, U. S. D. C. for S. D. N. Y.

Defendants were Jersey-Standard, Gulf, Socony-Vacuum (now Socony Mobil), The Texas Co., and Standard of California. Named participants but not defendants were British Petroleum (formerly Anglo-Iranian Oil Co.) and Royal Dutch Shell. The case dragged on for years as documents were subpenaed from all parts of the world. The case will continue, despite the partial settlement, against Socony Mobil, Texaco, and California Standard.

The consent settlements are not the work of the Antitrust Division alone. The policies in the decrees are the joint work of the Departments of Justice, State, and Defense, of CIA, the National Security Council, and even staff members of several Congressional committees.

While the newspaper reports of the settlement focused on the splitting up of the jointly-owned Standard-Vacuum Oil Co., the decrees themselves are more interesting and important in clarifying other types of cooperative activity which are permitted or prohibited under the final judgments.

2. The Basic Injunctions

For 25 years Jersey and Gulf are each enjoined, in key Article V, from combining with any competitor, with respect to crude oil or petroleum products, to—

(1) Fix prices or conditions of sale, in any foreign nation, or for import into the U. S. A. or into any foreign nation,

(2) Divide up territories, markets or customers, in any foreign nation,

(3) Restrict imports into or exports from the U. S. A.,

(4) Restrict sales in, or imports into, or distribution in, any foreign nation,

(5) Exclude distributors from any foreign market,

(6) Limit crude oil production in any foreign nation, except for legitimate technical reason,

(7) Exclude third persons from competing in a foreign nation,

and these injunctions are to apply only to a combination which "affects" U. S. foreign commerce. What would "affect" foreign commerce? For the first time, this injunction tries to define the term. *U. S. foreign commerce is presumed to be affected* (subject to rebuttal) *whenever the combination does one of the seven listed acts within three or more foreign nations at or about the same time, and involves either Jersey or Gulf, and any one of these leading world oil companies: Socony, California Standard, Texaco, B-P, or Royal Dutch Shell.*

In substance, this extraordinary presumption says that there probably would be a violation of U. S. antitrust laws, in these hypothetical examples:

> Jersey and B-P agree to limit crude oil exports from Venezuela, Argentina, and Algeria, even though no direct effect on U. S. imports is involved.
>
> Gulf and Shell divide marketing areas so that one gets Southern Europe, the other Northern Europe.
>
> Jersey and Socony fix gasoline prices in France, Chile, and Australia.

This application of the lawyer's definition of "substantial effect on U. S. foreign commerce" is probably premised on the likelihood of total impact from a number of relatively slight causes. It is a rule of thumb which Gulf and Jersey say won't hurt their business at all (except for the break-up of StanVac, which both Jersey and Socony publicly welcome).

The novel presumption does not necessarily permit combinations doing one of the listed acts, in less than three countries or with someone other than a major. The general injunctions apply to any combination "which affects the trade or commerce of the United States with foreign nations," regardless of where the forbidden acts take place, or who the competitor may be. A court interpreting this would probably determine that the combination was not unlawful unless it

"directly and substantially" affects commerce, although those qualifying adjectives are not in the decrees.

3. Defenses Are Recognized

The two decrees recognize certain exceptions to the basic injunctions. Article V declares that there is no violation if:

(a) The defendant is acting pursuant to a *requirement of foreign law,* applicable where the transaction occurs.

(b) The defendant is acting pursuant to a *request or official pronouncement of policy* of the foreign nation, *and* where failure to comply might result in the loss of business there.

(c) The agreement involves the defendant and any of its distributors or dealers abroad, but one which is not one of the other listed world oil companies.

(d) The agreement relates solely to a joint production, refining, or pipeline operation.

(e) The "other person" to the combination is merely a subsidiary of the defendant.

These exceptions go further than prior decrees in several respects. A foreign government "request" or "official policy" has been urged as a defense in the past, as in the *Sisal*[3] case, but with little or no success. Here it is adopted, if business loss is likely. This is a practical accommodation to the sovereign power of a foreign nation over local business organizations. The exemption for exclusive distributor agreements, or territorial divisions of dealers again is novel, but practical.

The provision eliminating intracorporate conspiracies puts to rest doubts raised in the *Timken*[4] dissent in this regard. This protection is extended to less than wholly-owned enter-

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[3] *U. S.* v. *Sisal Sales Corp.,* 274 U. S. 268 (1927).

[4] *U. S.* v. *Timken Roller Bearing Co.,* 341 U. S. 593 (1951).

prises: any company more than 50% owned is defined to be a "subsidiary."

Other articles of the decree give further protection to the defendants by allowing as a defense the use of international agreements, or U. S. laws such as the Webb-Pomerene Act and the Defense Production Act. Nor must a defendant violate any foreign law, provided it has tried in good faith to obtain waivers or exemptions. This is to take care of the *British Nylon Spinners*[5] case, where U. S. and U. K. courts conflicted.

4. Joint Marketing Operations

A very important provision of the injunction is Article VII(C). It forbids Jersey or Gulf from using a primary joint company to *sell* to certain customers crude oil or petroleum products within any foreign nation, or for import into the U. S. or into any foreign nation. A "primary joint company" is defined to be one in which two or more of the world oil companies (Jersey, Gulf, Socony, California Standard, Texaco, B-P, and Royal Dutch Shell) own voting stock *and* in which the defendant American oil companies own more than 50% of the voting stock. Complicated provisions prevent evasion of this definition.

The primary joint company can not sell to any customer other than to its own owners or their affiliates, with very few exceptions. The basic policy expressed here is that foreign joint ventures controlled by American majors should be permitted to sell only to their parent companies, or to affiliates of their parents. This restriction on the joint venture is a new departure from the traditional feeling that joint ventures should be able to sell to anyone at all. Apparently the theory of this novel policy is that if a joint venture is prevented from selling to customers *other* than its own parents, the parents will have to take its output and compete with each other. The result would be to put as many competing sellers

[5] *British Nylon Spinners, Ltd.* v. *Imperial Chemical Industries, Ltd.*, 2 All E. R. 780 (C. A.) (1952).

in the market place as if each had its own separate production source.

It is understood that this feature of the decree stalled the Jersey negotiations with the Government for months, until exceptions were included for existing sales arrangements by Aramco in Saudi Arabia, by a Jersey-Socony company in Indonesia, and by French Esso. This same feature is also said to be the reason why Texaco and California Standard have decided to stand trial.[6]

5. Joint Production, Refining and Pipeline Operations

The injunction also forbids Jersey or Gulf from voting its stock in any secondary joint company to expand into the petroleum marketing business, and from acquiring stock in such a company in the future. A "secondary joint company" is defined to be an oil company more than 50% of whose stock is owned by two or more of the seven named world oil companies, but less than 50% is controlled by any of the five major American companies (Jersey, Gulf, Socony, California Standard, and Texaco).

There is a general exception to this injunction, which permits, without limitation as to membership, a joint production operation either alone or in conjunction with a joint pipeline operation, or a joint refining operation. However, the joint refining operation must be near the producing wells. The joint production-refining venture is permitted to sell its products solely for consumption within the foreign nation where the venture is located, except that occasional inconsequential exports are allowed.

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[6] Less than two months after the *Jersey* and *Gulf* consent decrees, the Government sought to break up a domestic joint venture by a civil antitrust suit under Section 7 of the Clayton Act. The suit, against Pennsalt Chemicals and Olin Mathieson, alleged that the acquisition of stock in a joint company might lessen competition in the production and sale of sodium chlorate and other chemicals. *U. S.* v. *Penn-Olin Chemical Co., et al.*, D. J. Case No. 1583; Civil Action No. 2282, U. S. D. C., Del.

A further exception permits an otherwise prohibited joint venture to engage in business pursuant to foreign government requirements, or under an agreement with a foreign government, or at the request of the U. S. Government.

6. Breaking Up StanVac

Standard-Vacuum Oil Company (StanVac) was formed in 1933 to consolidate the Far East marketing operations of Socony and the crude oil operations of Jersey. Ownership was jointly held by the two parents.

Section VII of the Jersey Standard decree provides that Jersey will terminate the StanVac joint venture within three years, and divide the assets with Socony. Jersey is ordered, affirmatively, "to use reasonable efforts in accord with business judgment to compete with Socony" in marketing petroleum products in the area formerly served by StanVac. An exception is made for Indonesia, where the joint marketing arrangement may continue.

In 1959 StanVac had revenues of $1,027,000,000 and assets of $885,000,000. The size of the split-up can be imagined. Although Socony Mobil was not a party to the consent decree, it was evidently willing for business reasons, as well as legal requirements, to go along with the dissolution.

7. Conclusion

These two consent decrees are major interpretations by the Justice Department of the application of the Sherman Act to international business. They flash a red light to any *pattern* of price fixing or other restrictive arrangements between the subsidiaries of major American companies—and their foreign competitors—operating abroad.

In addition, the decrees are a significant guide to framing joint ventures, at home as well as abroad. Henceforth, any joint enterprise controlled by competing American companies may well be required to sell its output back to its parents only, and to no one else.

BUSINESSMEN'S CONCEPTS OF "INJURY TO COMPETITION" †

by

Robert C. Brooks, Jr.*

Injury to a competitor is not always the equivalent of injury to competition. Awareness of this, and the ability to distinguish one from the other, can forestall much useless litigation. Here is a set of basic questions designed to serve as a yardstick to help the business community identify and measure true injury to competition.

Is there a valid distinction between "injury to competition" and "injury to a competitor"? It has been frequently stated that the Federal Trade Commission has confused the two types of injury in its enforcement of the Robinson-Patman Act,[1] and has ignored the fact that injury to individual competitors is to be expected as a necessary element of healthy and vigorous competition.[2]

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1 To be illegal under the Act, a price discrimination must be such that its effect may be ". . . substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them . . ."

2 *Report of The Attorney General's National Committee to Study the Antitrust Laws* (Washington, 1955), pp. 164-65. Also see Corwin D. Edwards, *The Price Discrimination Law* (Washington, Brookings Institution, 1959), pp. 518-45.

What is the thinking of the business community regarding these two types of injury, and is there a distinction between them in the eyes of businessmen? The answers might not only throw light on the manner in which the Robinson-Patman Act should be enforced, but might suggest an approach toward greater consensus of opinion that would materially help in self-enforcement of the law.

If the extent of litigation could be reduced, it would free both the regulatory agency and the business community for more productive work. Furthermore, most businessmen believe that competition is vital to the proper functioning of our economic system. Our public policy of promoting competition is often cited as one of the key reasons for the superiority of American, as opposed to European, economic performance.

For purely ideological reasons, and apart from possible violation of the law, a businessman might wish to avoid actions which injure competition. But the businessman must find an acceptable basis for distinguishing injury to individual competitors from injury to competition.

Unless the distinction is properly made, he may, simply because a competitor would be hurt as a result, curtail actions which would actually improve the vigor of competition. Alternatively, the businessman should avoid the error of concluding that competition is not injured by his actions, simply because none of his competitors in the market are thus injured.

Views Differ With Interests

It would, of course, be unrealistic to expect a single viewpoint on this question—or any other question—from a group as diverse as that which makes up the business world. Workers in government regulatory agencies have noted that there is no one business attitude toward "competition," especially

in regard to whether a particular competitive practice, such as price discrimination, is "unfair" or calls for government regulation.

Depending on whether the businessman represents a large or small firm, and whether his industry is expanding or declining, his opinion of the extent of competition in a given market situation might differ. There might also be a difference in his evaluation of whether specified practices would help or hurt competition. As stated by a member of the Federal Trade Commission, Lowell Mason, in his dissent to the Commission's Standard Oil decision:

> "When you meet your competitor's lower price so as to keep a customer he sought to take away from you, he feels he has been injured. Of course he has, but that does not mean that competition has been injured. On the contrary, it may have been improved.
>
> "In theory, it would be nice if one could do business without having people come along and meet his price. But in a free economy people are always trying to do that very thing: inveigling customers away by better services or cheaper prices. That's the consumers' protection. The well-established companies refer to these people as 'chiselers.' Those who are not well established, and who are trying to secure a foothold in the market place, refer to the well-established companies who meet their lower prices as 'monopolists' or 'price discriminators.' It all depends on which foot the shoe is on." [3]

To what extent can generalizations be made regarding the meanings to men of affairs of "competition" and "injury to competition"? Further, does this suggest a way of determining whether or not injury to competition has occurred which avoids confusion with the question of injury to individual competitors?

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[3] *Standard Oil Co. of Indiana*, 43 F. T. C. 56, 65-66 (1946).

We shall attempt to answer these questions on the basis of a consideration of public statements made by businessmen, and of the testimony of businessmen in cases where the Robinson-Patman Act has been enforced.

Meaning of "Competition"

Competition in its ordinary business sense means that rival companies exist and that to a greater or lesser extent these companies attempt to divert trade from each other. The market in which this competition takes place is not the impersonal, atomistic market of perfect competition, and often consists of only a few firms or includes very large firms.

When there are few firms, the actions of at least some of them will be watched by the others. Such actions, when observed, will be sufficient to result in offsetting actions by the others. Since price cuts are readily countered, open price cutting is not an attractive means of rivalry for such firms unless one of them believes that its share of the increase in the total market will make the price cut profitable.

Otherwise each firm will seek to avoid open price cutting, and will try rather to match the prices of its rivals. Thus, the desire to divert trade from competitors is often manifested only in attempts to offer a better product, a distinctive product, or better delivery and service of the firm's product.

If, however, as is often the case, agreement cannot be reached among all competitors as to the "unwiseness" of price competition, it will probably be an important part of the competitive picture. A firm must then be willing to initiate or to meet lower prices in the market, particularly if the buyers have a good knowledge of prices.

It must always be remembered, of course, that to many businessmen, competition can exist in "vital" form without price competition. Other types of competition may be exceedingly troublesome in themselves. "Competition" as a term

may mean many things other than those which are normally included in the concepts of price and non-price competition.

Sutton, a sociologist, and his colleagues in the field of economics have written that businessmen broaden the meaning of competition to mean "any pressure from without the firm which impinges on management and influences management decisions, whether it arises from business firms in other markets, suppliers, customers, or the general public."[4]

Workable Competition

There is a great similarity in the thinking of some businessmen to the economic thinking in the concept of "workable" competition. As expressed by Corwin D. Edwards, "This competition consists in access by buyers and sellers to a substantial number of alternatives and in their ability to reject those which are relatively unsatisfactory."[5]

There is evidence that the concept of workable competition has been picked up and incorporated into business thinking regarding desirable types of competition. The National Association of Manufacturers Research Department has written that, from the viewpoint of the individual buyer, the intensity of competition "depends on the number of alternative choices open to him." This point serves as a basis for the further statement that a few producers, each selling a national market, are more competitive than a large number of producers, each operating in a single locality where few or no competitors are found.

The viewing of competition in terms of availability of alternatives to buyers is also reflected in the following statement of the Procter and Gamble Company:

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[4] Francis X. Sutton et al., *The American Business Creed* (Cambridge, Harvard University Press, 1956), pp. 176-77.

[5] *Maintaining Competition* (New York, McGraw-Hill Book Company, Inc., 1949), p. 9.

"It seems unwise to produce Product A and ignore the preference of the 45% favoring Product B if the market is sufficiently large to carry both. Production of the second product adds to the variety of products available to the consumer. This breadth of choice is the basis of modern supermarket merchandising. . . . [This] thinking merely carries the principle of competition, which is basic to the functioning of the American economy, one additional step." [6]

Joseph Seitz, the president of Colonial Stores, reflected this view of competition in a year-end statement: "Competition during 1957 might become intense to the general benefit of the consumer. . . . The most significant trend in food retailing today, it seems to me, is that we are giving the consumer constantly increasing freedom of choice." [7]

Symbol of Fair Play

But competition plays much more than a logical role in the thinking of businessmen. As a symbol of fair play it has a widespread emotional appeal both inside and outside the business community. The explanation given by Sutton and his associates for this appeal is that competition symbolizes our society's basic patterns of universalism and achievement:

"In all kinds of contests—athletic, scholastic, political, occupational, as well as business—we have a strong moral commitment to open the race equally to all, to impose the same rules on all contestants, to expect each to do his best within the rules to win, to award prizes to the winners, to applaud the efforts of the losers and expect them to be 'good sports.' Nothing is more important

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6 Procter & Gamble Co., *Intra-Company Product Competition* (1956).

7 News release for 1956 year-end business sections.

than 'fair play'—an equal chance for all contestants and adherence by all to a set of impartial rules." [8]

The symbolic idea of competition described above has been reflected in the statements of businessmen. Edward H. Thurston, late vice-president and director of Liggett and Myers Tobacco Co., once said, "The competition was very fierce, or a better word, I think, is 'rivalry.' 'Rivalry' describes it much better than 'competition.' It was just the same kind of rivalry as in a football team or a baseball team." [9]

Even under the basing-point system, an appeal to "fair play" was made by Kosmos Cement Company in a letter to the Louisville Cement Company protesting price irregularities by the latter company. The letter stated in part, "You also recognize an obligation of what I might call sportsmanship to compete with the companies on their own level." [10]

The necessity for "fair play," "an equal chance for all," and "a set of impartial rules" cited by Sutton, et al., is also reflected in the following excerpt from a letter to a U. S. Congressman by George J. Burger, vice president of the National Federation of Independent Business:

> "In the booklet of the United States Chamber it states as a recommendation, item No. 3: 'Buying. Goods well bought are half sold.' Well, there can't be any argument on that. That is the reason why you and 392 other Members of the House recently voted for the needed amendment to the Robinson-Patman Act . . . to protect present small business and those going into business, to see that they get a fair and equal price from their supplier. . . .

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[8] *The American Business Creed, op. cit.* note 4, *supra*, p. 366.

[9] Transcript of Record, Vol. VII, p. 4512, *American Tobacco Co., et al.* v. *U. S.*, 328 U. S. 781 (1946).

[10] *The Cement Institute*, 37 F. T. C. 87, 146 (1943).

> Another comment in the booklet is: 'The successful merchant is the man who gives good values for the dollar and plays fair with everybody.' We will go along with that 100 percent provided the supplier plays fair with all his customers, and not just a favored few." [11]

In a similar vein, a pamphlet of the United States Wholesale Grocers Association states:

> "The first principle of competition, whether it be in business or sports, is that all contestants be treated fairly and none be given an unnatural advantage not given to the others. This is an elemental rule of fairness without which there can be no contest, no real competition. . . . The Robinson-Patman Act is a basic necessity for preserving competitive opportunity.
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> "It serve as an umpire whose job it is to make sure the game of competition is played fairly. Allowing a favored few to defeat their rivals by securing discriminatory advantages through unfair use of superior buying power or through economic pressure violates a basic principle of competition."

Meaning of "Injury"

The historical purpose of the addition in the Robinson-Patman Act of the standard of "injury to competition with" a grantor or beneficiary of price discrimination was to prevent "unjust" injury to individual competitors or groups of competitors. This narrow standard of injury to "competition with" is as much a part of the law as the broad economic standard of injury to market competition.[12]

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11 Letter of July 18, 1956, to Congressman Frank Thompson, Jr.

12 While our discussion is largely concerned with the broad standard of injury, it must be remembered that the Commission and courts have an additional standard to enforce as well. Under this additional standard of "fairness," the law can be violated by price discrimination which results in injury to individual competitors, and regard-

Many businessmen would agree with the published statement of the National Association of Manufacturers which argues that injury to competition occurs only when monopoly or conspiracy exists. After defining monopoly as the opposite of competition, the Association goes on to say that monopoly exists when there is only one seller or, if more than one seller, they act as a unit in determination of price and conditions of sale. Subsequently the statement seems to limit harmful conspiracy to those cases where the supply is controlled so as to "fix a price that will yield the members the largest possible profit." [13] This almost suggests that conspiracy to charge a "fair price," assuming this price is less than the profit maximizing price, would be harmless to competition.

N.A.M. List

The N.A.M. goes on to list the following specific practices as injurious to competition: trusts, holding companies, merger (if "real intent" is determinable), local price cutting to destroy competition, loss leaders, and "special arrangements . . . made with jobbers and involving special rebates or discounts and sometimes the boycotting of certain independents."

The list is apparently based on practices of firms which have been found guilty of violation of our anti-trust laws. Sutton and his colleagues have commented that, in published statements, businessmen have reduced the question of adherence to competitive norms to one of conformity with the antitrust laws. Thus, failure to be prosecuted can be interpreted

less of the effects on market competition. Even though an enforcing agency finds a violation of the Act in cases where a finding of injury in the broad sense would not be justified, this alone does not mean that the agency has confused "injury to competition" with "injury to competitors." Since price discrimination can be illegal under either standard, the enforcing agency could hardly dismiss a case where either of them applied. If the agency wished to bring enforcement into accord with an economic approach, however, it could seek to limit its selection of cases for complaint to those in which the broader, economic standard seemed to apply.

[13] *The American Individual Enterprise System* (New York, McGraw-Hill Book Company, Inc., 1946), Vol. II, pp. 592-94.

as a certificate of conformity to the competitive code. It follows that conspiracies are isolated instances in a class with embezzlement and fraud.[14]

Let us turn from statements intended for publication to a more grass roots appraisal of the meaning of injury to competition. In the F.T.C.'s *E. B. Muller* decision[15] we find reported as evidence some interesting correspondence among businessmen who had little doubt that injury to competition was taking place in their market.

Case History of Competitive Injury

Only three firms were engaged in the processing and sale of chicory, a product which can be mixed with coffee to impart certain flavors. The principal market for chicory was New Orleans, but it was sold all over the United States. Forty percent of Muller's sales were in the New Orleans territory, and 75 percent of the sales of Heinr. Franck Sons, Inc., were in that territory, while all of the sales of R. E. Schanzer, Inc., were in the New Orleans territory. There was a common control of the Muller and Franck companies, and they were in agreement not to compete for each other's business.

Schanzer was the principal importer of processed chicory. After the tariff on processed chicory was increased at the petition of Muller and Franck, Schanzer, in 1930, installed a plant in New Orleans for processing imported chicory root. In 1933, Schanzer installed a plant for processing domestic chicory root in Michigan, the only state in which it was grown. The reaction of Muller and Franck was to embark on a program of local price cutting in the New Orleans territory. The purpose was to eliminate Schanzer, their only competitor.

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14 *The American Business Creed, op. cit.* note 4, *supra*, pp. 368, 166.

15 33 F. T. C. 24 (1941).

The value of competition in the market was evident to the purchasing officer of a large user of chicory, who in 1937, wrote in an inter-company communication:

> "There is no getting around it but what if Schanzer had stayed out of the picture we would be paying much higher prices for chicory from either Heinr. Franck or Muller so we really owe something to them. Muller and Franck have always had an opportunity to quote on our business and they always quoted the same price. Now, since Schanzer has gotten the business they are making a strenuous effort to get it back and just the minute that they have eliminated Schanzer I feel quite sure that their prices would be much higher." [16]

Intimidation

The perpetrators of the "injury" in this market also seemed to have a very clear picture of the meaning of the term "injury to competition." The sales manager of the Muller company wrote the Port Huron office as follows: "We would suggest that they be given a price of 6 cents Jacksonville, . . . unless different information should come to hand of Schanzer having actually closed up entirely, in which case of course, a better price could be obtained." [17] The sales manager also used the possibility of creating a monopoly as a threat to purchasers. Again utilizing the idea of available alternatives to the buyer, he wrote a sales representative:

> "However, we feel sure that if you will diplomatically advise your trade that Schanzer surely will not last much longer, which is certainly proven by the repeated offers he has made to us to buy him out, they will see the handwriting on the wall, and realize that if Schanzer drops out, which he undoubtedly will, they will have to

[16] *Ibid.*, pp. 51-52.

[17] *Ibid.*, p. 52.

come back to us, and it should appear reasonable to them to consider that we would not feel so kindly towards those who have gotten away from us for a slight consideration in price, than to those who stuck to us and they would be the ones in future who will receive the greatest consideration. . . . Of course it is needless to tell you that this will have to be handled very carefully, not in the nature of a threat but just as a friendly suggestion on your part, and we believe it can be handled very much better by you than by the writer, as such *intimidation* coming from him would not take as well." [18] (Italics are the author's.)

Observing that the predatory tactics on Schanzer might result in entry of new firms, the need was seen for warding off such potential competition under threat of "injury." Again in terms of alternatives in the market, the president of Muller wrote:

"There is the danger in letting one customer get too big as we have done by rebates to Reily. Reily has been able to undersell his competitors through our help and when he gets big enough he will unquestionably attempt to go into the business himself. The only thing that will prevent him will be the fear that if he does do this there will be a fight and every 5 bag buyer in New Orleans will get his chicory just as cheap as Mr. Reily can produce it for himself. Reily would not be able to sell much outside of his own trade and if his chicory costs him as much as his small competitors, all of Reily's advantage is gone." [19]

While attempting to reduce the number of alternatives to the buying side, the president of Muller recognized the desirability of many alternatives to his, the selling side of the

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[18] See note 17, *supra*.

[19] See note 17, *supra* p. 53.

market, writing in the letter previously quoted, "we are damaging our other . . . trade by giving Reily such a large rebate. It is dangerous for us to increase Reily's trade at the expense of his competitors."

In this case, there is an identity of injury to competition with injury to a competitor, since Muller and Franck were in agreement not to compete with each other, and Schanzer was their only competition in the market for chicory. Since there was no possibility of confusion of the two concepts of injury in this case, it provides an excellent source of nonpublic beliefs of businessmen as to the nature of competition and injury to competition.

A rather remarkable aspect is the recurrent reference to availability of alternatives as a measure of competition. Furthermore, this availability of alternatives is viewed as a protection to firms on the other side of the market, whether it be the buying or the selling side. This grass roots concept of competition, which was brought to light through a search of company files, was expressed three years before the enunciation of the concept by economists.

Confusion of Terms

Regardless of his thinking about "competition" in general, there is evidence that, in specific cases, many a businessman is prone to make his determination of "injury to competition" turn on whether or not there is "injury to a competitor"—specifically himself. Primarily occupied with his own company, and with little time for analysis of the industry, much less the overall economy, he often has no reason to think that competition has been injured unless *he* has been injured.

For example, there is widespread feeling that if favored firms do not use price advantages to reduce their own prices and thereby divert trade, they have done no "injury" to their competitors, therefore there is no injury to competition.

Morton Salt Case

Thus, in the *Morton Salt* case,[20] witnesses were asked two questions: "If you were selling Morton's Blue Package salt at $1.65 per case while at the same time a competitor seller was selling it for $1.63 per case, would your business be affected?" and "If you were paying $1.50 per case for Morton's Blue Package salt while a competitor was paying $1.40, would your business be affected?" Twenty-nine of the fifty-one witnesses "observed that while the competitor enjoying the discount might have an opportunity to make more profit, there would be *no effect on competition,* if . . . the discount was not used to reduce the sale price of the product." (Italics are the author's.)

Of course this interpretation is to ignore the function of profits in the allocation of resources, and also, more at home to the businessmen, to ignore the fact that profits might be used for non-price competition or for expansion of the competitor receiving the greater profits.

The feeling that a discriminatory price advantage causes no injury to competitors of the favored firm unless that firm chooses to reflect the advantage by price cutting is also illustrated in a series of cases involving automobile parts.[21]

In these cases, jobbers who had been disfavored by price discriminations denied that they had been injured as a result. They admitted however that their basis for believing that they were not injured was "the fact that their competitors all followed the suggested resale price" and "that there was no price competition in their particular trade areas." (It is also possible that the "disfavored" witnesses enjoyed favored positions in the purchase of other items, and did not wish to

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[20] 39 F. T. C. 35 (1944).

[21] *Moog Industries, Inc.*, 51 F. T. C. 931 (1955); *Whitaker Cable Corp.*, 51 F. T. C. 958 (1955); *P. and D. Manufacturing Co.*, 52 F. T. C. 1155 (1956).

do anything that might lead to an upsetting of these relationships.)

Minneapolis-Honeywell Case

A businessman whose firm is doing well may think of price differentials as just part of the normal competitive picture along with numerous other advantages and disadvantages, one competitor having one advantage and another competitor having another advantage. Thus, in the *Minneapolis-Honeywell* case,[22] some burner manufacturers who paid higher prices testified that "they do not lose business as a result of paying such higher prices, and that they considered other factors of far greater importance in determining the price of the completed burner. They referred to such matters as manufacturing methods, overhead, distribution costs, service, advertising, as having an important bearing on competitive prices in addition to the costs of the component parts." [23] It appears that these particular businessmen felt that, on balance, they were not injured by competition, such as it was, and therefore there was no injury to competition.

Others of the burner manufacturers testified that they had lost business to certain competitors because of the price differential, therefore implying injury to competition. To firms in the burner industry, the test of injury to competition was apparently whether or not the firm was losing business. This test not only ignores effects on the vitality of market competition, but even ignores types of injury which might occur to the individual firm, even though it is gaining sales.

A firm which is gaining sales would be declining in its relative importance in the market if the market were expanding at a faster rate than its sales. And even if a firm is gain-

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[22] 44 F. T. C. 351 (1948).

[23] *Minneapolis-Honeywell Regulator Co.* v. *F. T. C.*, 191 F. 2d 786, 791 (7th Cir. 1951).

ing in market share, its gains might well have been greater, if its competitors did not enjoy the benefit of discriminatory treatment from suppliers.

Turning to effects on market competition in general, if some of the competitors work under a persistent handicap unrelated to efficiency, this destroys the validity of the competitive process as a means of reducing the importance of inefficient and unwanted firms and increasing the importance of those firms which make better and more efficient use of resources.

Workable Competition

There is clearly a need for a logical distinction between "injury to competition" and "injury to a competitor." In cases such as the Muller case, injury to competitors would occur along with injury to market competition, but in other cases, such as those involving collusion, there might be no injury to competitors although market competition was virtually eliminated. In still other instances competitors might be injured while market competition was unaffected or even improved. The latter case might be the result, for example, of promotional pricing on the part of a firm with a superior product. Let us see if the concept of workable competition can suggest an approach to determination of "injury to competition" which avoids its confusion with "injury to a competitor."

Generally speaking, in terms of workable competition, if the real alternatives in the market are increased, competition is improved; if the real alternatives in the market are decreased, competition is injured. But due allowance must be given for the competitive process of selection whereby inefficient and undesired alternatives are eliminated. Thus, the presence of effects indicating possible injury to competition might be offset by other effects indicating that there was actually an improvement in competition.

For instance, if there were numerous suppliers all of whom were lethargic, the entry into the market of an experimental and alert competitor might, by subsequent elimination of inefficient firms, cause a reduction in the number of sources of supply and also cause a greater responsiveness of the remaining traders to profit and loss incentives.

There would be an elimination of those firms who were unresponsive to the market, but the remaining firms would actually afford the public a greater variety of real alternatives than existed with the greater number of suppliers. Here a reduction in the number of suppliers is actually an indication of the vitality of competition rather than of an injury to competition. While the elimination of lethargic competitors clearly indicates injury to those eliminated, it would not indicate injury to competition itself.

It should also be noted that it is possible for the current or short-term effects on competition to differ from the predicted or likely subsequent effects on competition. Thus, the elimination of competitors may reflect active competition for a period of time, as indicated above, but, if this results in the elimination of all competitors but one, a later consequence is that of a severe injury to competition in that competition itself would be eliminated. In cases where the immediate effects of a practice differ from the subsequent effects, the controlling effects, for overall evaluation, would generally be the subsequent effects.

Short vs. Long Term Effects

This is because the short-term effects would be clearly temporary, and conditions would be tending toward the subsequent effects. It must be considered, however, that we cannot be as certain of the nature of the ultimate effects, since they are further away in time. The more uncertain the ultimate effects, the more weight must be given to the short-term effects.

Change is cumulative, and effects now deemed subsequent can themselves be superseded by still later effects. If, for instance, it is anticipated that competition will eliminate all but one competitor in a market, a subsequent increase in price might attract new competitors into the market. Thus entry, or simply the likelihood of entry, of new competitors tends to keep the prices of existing firms near the competitive level, and also tends to make the latter firms efficient and progressive, since otherwise there would be an entry of additional competitors as a result of the profit opportunity.

Ease of entry into the market also makes collusive price agreement among existing firms less attractive, since an increase in price may cause newcomers to enter the market, thus reducing the market shares of the initial participants in the agreement. The agreement itself could be wrecked in the process.[34]

Weakening of Competition

Injury to competition may take the form of a reduction or weakening of competition, as well as that of an elimination of competition. Therefore, the existence of competition in a market does not mean that competition could not have been injured in that market, or even be in process of being eliminated from the market.

The determination of "injury to competition" implies a relative evaluation of the competitive situation with and without a given act or practice such as price discrimination. Rather than the more difficult, and more debatable, problem of determining to what extent a given type of competition

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34 Ease of entry would also serve as a limit to effective predation, since new firms might rise up to replace those eliminated at a cost to the predator. I feel, however, that successful use of predatory price discrimination would itself result in a barrier to entry of new firms. See also Robert C. Brooks, Jr., "Price Cutting and Monopoly Power," *Journal of Marketing*, Vol. 25, 1961.

exists, the problem here is one of whether or not the forces of competition are improved or injured.

Yardstick for Injury

On the basis of the concept of workable competition as expressed by Corwin D. Edwards,[25] determination of whether or not a practice results in injury to competition would involve answering the following questions:

1. Does, or will, the practice result in the elimination of a substantial alternative or group of alternatives in a market for substantially the same product or service?
2. Does, or will, the practice result in an important rival or group of rivals substantially limiting their competitive activities in order to appease, come to terms with, or avoid or lessen price warfare with a firm utilizing the practice? Does, or will, it result in a trader becoming so large that his rivals lack capacity to take over a substantial part of his trade?
3. As a result of the practice, is there, or will there be, a substantial trader or group of traders who are less responsive to profit and loss incentives?
4. Does, or will, the practice facilitate an arrangement which substantially limits the extent of price competition among rivals?
5. As a result of the practice, is it, or will it be, substantially more difficult for new traders to enter the market?
6. Does the practice substantially reduce the access by important traders or groups of traders on one side of the market to important traders or groups of traders on the other side of the market, or will it have this effect?

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25 *Maintaining Competition*, *op. cit.* note 5, *supra*, pp. 9-10.

7. Does, or will, the practice substantially implement a preferential status for an important trader or group of traders on the basis of law, politics, or commercial alliances?

Basis for Decision

While one or more of these effects may be readily apparent in some sets of facts, in other cases there may be alternative explanations of the evidence. In such cases, one might proceed in the determination of the above listed questions by asking the question, "Based on the facts, is there reason for the practice having this effect on the trader?"

If the answer is affirmative, one could then ask, "Are there any additional facts or relationships which would accompany this effect, but which would not otherwise exist?" The presence of such additional facts or relationships would constitute a relatively solid basis for decision.

There may in any case be disagreement as to how important the affected firms were, and whether the reduction in alternatives was substantial or not. This determination would not necessarily be difficult, however, for many, if not most, cases would be such that the alternatives involved would either be rather clearly substantial, or else insignificant in the market.

It must also be remembered that in imperfect markets some degrees of price discrimination, lack of knowledge, barriers to entry and exit, and inefficiency are to be expected, and caution must be exercised before concluding that a given effect on the market structure is due to any one of them.

Reduction in Alternatives

If a reduction in alternatives is due to inefficiency, we may not improve the situation by elimination of price discrimination which also happens to exist in the setting. We must

make a judgment of whether or not the price discrimination was one of the means responsible for reduction in alternatives.

Thus, not only the effects on the market structure, but also the means by which the effects took place must be considered as part of the concept of injury to competition. If other possible causes, such as inefficiency, are considered unimportant, and the presence of a practice capable of injuring competition can be shown, this—if accompanied by one of the effects listed in this section—would constitute as much basis as could be logically found[26] for a determination of injury to competition.

Although for many businessmen the symbolic aspect of competition is one of its most important elements, it is unlikely that anything near a general agreement could be reached as to whether or not many practices (e.g., specific cases of secret arrangements or of favoritism) were "fair" or "sportsmanlike."

Conclusions

The diversities among firms, of size, relative position, and prospects, as indicated in our introduction, mean that an agency attempting to act as an umpire of fair play would likely end up either as a proponent of one of several views as to what is "fair," or else wash its hands in the manner of Pilate.

On the other hand, there may be certain practices on which fairly general agreement could be reached. In such cases an attempt could be made to specify the practices which were to be prohibited. The main problem would be to confine the list to practices which have a negative or a neutral effect on the forces of competition.

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26 Logically, causality cannot be proved, but can be inferred. The conditions given in the above paragraph would make the inference of "injury" reasonable, and a more solid basis could never be found in such relationships.

There would be temptations on the part of some businessmen to seek the prohibition of practices hurtful to competitors, but helpful to competition itself. Thus, price-cutting would be considered by many businessmen as chiseling or failing to play the game, and therefore be considered as an injury to competition.

Perhaps the best hope for greater consensus by businessmen as to the nature of injury to competition lies in the concept of workable competition. This is because of the widespread incorporation into present business thinking of the idea of "available alternatives" which is a central part of the concept.

Furthermore, many of the tests of workable competition, such as "no trader so powerful as to be able to coerce his rivals," "no deliberately introduced obstacles to access by traders to those on the other side of the market," and "no substantial preferential status," would also be accepted on the basis of the businessman's symbolic idea of competition—sportsmanship and fair play. General acceptance by businessmen of such a standard would also have the advantage of isolating the broader concept of "injury to competition," thus reducing the likelihood of its confusion with injury to an individual competitor.

THE TROJAN HORSE OF WORKABLE COMPETITION

by

Ralph L. Nelson*

During the 1950s, two counter-trends were evident in the thinking on the status of big business in the United States under the antitrust laws. On the one hand, big business received a vote of confidence and appreciation from a number of influential writers. Among these were persons like Adolph Berle and David Lilienthal who, two decades earlier, had been outspoken in their criticism. John Kenneth Galbraith also defended the positive contributions of big business and pointed out that there are forces in the economy which exercise "countervailing power" on our giant corporations, and hence limit their ability to profit at public expense.

Yet at the same time the government's antitrust policy moved toward a less permissive treatment of big business. In 1950 the law relating to the legality of business mergers was tightened. In 1957 a federal court ordered the Du Pont Company to divest itself of its holdings of 23 per cent of General Motors stock. In 1958 the merger of the Bethlehem and Youngstown steel companies was enjoined. Finally in 1960 the price-fixing scandal uncovered in the electrical industry resulted in the imposition of huge fines on the companies involved and jail sentences for some of their executives. In the size of the corporations and in the severity of the sentences these prosecutions have seen few equals since the great oil, tobacco and explosives trusts were dissolved in 1911.

Economists have always been sharply divided on the proper public policy toward competition and monopoly. It

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would therefore be risky to attribute any trend in legislation or judicial interpretation to the course of the economists' arguments. However, more and more the advice of economists has been listened to, and even sought, by both lawmakers and judges. When an important economist speaks out, one can be reasonably sure that his views will reach, and often influence, the makers of antitrust policy.

Professor George Stocking of Vanderbilt University is an economist who approves of a tough antitrust policy, and he has been a leading and influential spokesman for this view. In *Workable Competition and Antitrust Policy,** he has assembled under one cover 10 articles which he wrote between 1953 and 1959. The book begins with his presidential address to the Southern Economic Association, provocatively entitled "Saving Free Enterprise from Its Friends," and ends with his presidential address to the American Economic Association. The other articles appeared in various economics and law journals.

The concept of "workable competition" was developed in 1939 by Prof. John Maurice Clark as an answer to the problem presented by Prof. Edward H. Chamberlin in his book, *The Theory of Monopolistic Competition,* published in 1933. According to Prof. Chamberlin, firms in an oligopolistic market situation (wherein a few sellers dominate the market) are likely, *without conspiring,* to behave like monopolists. For where there are only a few sellers in a market, the policies of one firm are naturally evident to and strongly affect the others. Such interdependence impels firms to avoid the active, self-defeating and potentially damaging kinds of competition, and helps insure high profits for all.

This theory was disturbing to both friends and critics of the Sherman Act. Were the Act's prohibitions against conspiracy inadequate to deal with oligopolies? If not, how could

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* *Workable Competition and Antitrust Policy.* George W. Stocking, 451 pp. Nashville, Tenn.: Vanderbilt University Press. $7.50.

antitrust legislation be broadened to cover oligopolies without bringing about a wholesale reconstruction of industrial markets?

The theory of *workable* competition offered a way out of this dilemma. Prof. Clark argued that, since perfect competition is neither achievable, nor desirable, some unavoidable departures from competition must exist. Thus, perhaps, other offsetting and *avoidable* departures might be justified as well.

He argued further that, in the long run, it was likely that potential new competitors and new substitute products would force oligopolists to behave like competitors. He also pointed out that unrestrained competition among oligopolists could cause such large losses in bad times that it would be impossible to recoup them in good times, an eventuality that might prove socially disastrous in the long run.

These arguments fell on receptive ears. It was not long before many lawyers and some economists were insisting that workable competition be adopted as a standard for determining antitrust violations.

Prof. Stocking rejects this doctrine and fears that its application will lead to lax enforcement of the antitrust laws. He presents evidence to show that the concept of workable competition has been embraced and promoted most fervently by lawyers interested in the sucessful defense of antitrust cases. He cites examples of economic analysis, where attempts to examine an industry in terms of "workably competitive" performance have resulted in conclusions based on not much more than the preconceptions of the analyst. He describes court decisions in which the number of substitute products competing in the market with the defendant's products has been so generously defined as to nullify the use of "market shares" or "anticompetitive policies" as criteria for determining whether or not a company is monopolistic.

His comments on the Attorney General's National Committee to Study the Antitrust Laws are revealing. Though,

according to Stocking, "the demand for the amendment of the law to incorporate the concept of workable competition and the rule of reason occasioned the Committee's creation, . . . it specifically rejected the 'theory' cautioning that it 'does not provide a standard of illegality under any of the antitrust laws.' "

Whether the 52 lawyers on the Committee could not persuade the eight economists and one labor leader, or whether they recognized that it would be almost an impossible task to persuade Congress to change the law is not known. Stocking's "Trojan horse" of workable competition apparently still waits outside the gates of Congress, though it may have been admitted by some courts.

While Stocking's arguments are forcefully expressed and forthright, he is obviously sincerely committed to a course of moderation. In his first article he sounds his keynote: "The aim of . . . policy should be to nurture the dynamic elements in private capitalism. . . . An indiscriminate program of disintegration is neither economically feasible nor politically expedient. . . . Industrial structure and market behavior need careful analysis before the use of the surgical knife. Since a dynamic capitalism relies on the profit motive, penalization of mere bigness might well prove fatal. Hope lies more in guiding the future than in undoing the past."

NEWS AND VIEWS

The Social Objectives of Antitrust Policy

by

Irwin M. Stelzer*

Underlying much of the argument concerning the proper legislative program to be adopted, or judicial policy to be followed, vis-à-vis the small businessman, and the retailer in particular, is an often unstated difference of opinion concerning the goals of the antitrust laws. If we assume that those statutes have as their sole goal the maximization of economic efficiency, many of our public policy problems are simplified, although not necessarily solved in consonance with the public interest. If the big chain store or discount house is more "efficient" than the small retailer, then, by this standard, we would let the latter perish in the economic struggle; by some process of economic Darwinism the fit shall survive, the "unfit" shall perish. If, such reasoning continues, laws such as the McGuire Act[1] lead to higher prices than would otherwise prevail, repeal the law; the resulting lower prices will benefit the sovereign consumer and harm only the inefficient businessman, who will be forced to make way for his more efficient (i.e., lower-priced) competitor.

Despite the theoretical (and perhaps even the actual) advantages which would, we are told, flow from such a system of Darwinistic competition, it is difficult to accept the view that our antitrust statutes were enacted to legislate such a system into being. Rather, it can be shown that the Sherman

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1 15 U. S. C. A., Sec. 45 (1952).

Act,[2] and the legislation subsequently adopted to extend it, had a social purpose at least coordinate with its economic purpose. As Thorelli has put it in his study of the political and intellectual origins of the Sherman Act:

> Perhaps we are even justified in saying that the Sherman Act is not to be viewed exclusively as an expression of economic policy. In safeguarding rights of the 'common man' in business 'equal' to those of the evolving more 'ruthless' and impersonal forms of enterprise the Sherman Act embodies what is to be characterized as an eminently 'social' purpose. A moderate limitation of the freedom of contract was expected to yield a maximization of the freedom of enterprise.[3]

Further, Senator Sherman himself pointed out that one of the objects of the legislation which bore his name was the maintenance of political freedom.[4]

Thus, it would be absurd to pretend the Sherman Act was intended to legislate the economic dynamics of a Joseph Schumpeter.[5] It would be equally extreme, on the other hand, to assume that the framers of antitrust policy were unconditionally committed to the disintegration of giant business regardless of its economic justification. Congress in 1890 simply did not make up its mind about the policy to adopt toward firms that reach gianthood through superior efficiency alone. And economists of the day were of little help, being "handicapped and confused by the inability to differentiate

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[2] 26 Stat. 209 (1890), as amended, 15 U. S. C., Sec. 1, 2 (Supp. 14, 1957).

[3] Thorelli, *The Federal Antitrust Policy: Origination of an American Tradition*, 227 (1954).

[4] *Ibid.* Compare the subtly different views set forth in Report of the Attorney General's National Committee to Study the Antitrust Laws, 2 (1955). See also Dirlam, Book Review, 16 Journal of Economic History, 99 (1956) (reviewing Thorelli, *op. cit. supra* note 3).

[5] See especially Schumpeter, *Capitalism, Socialism and Democracy*, 87-110 (3rd ed. 1950). Briefly, it is Schumpeter's contention that restrictive practices are unavoidable incidents of a long-run process of economic expansion. These practices, it is said, "protect rather than impede" progress in much the same way that brakes make it possible for an automobile to travel at high speeds.

between the large-scale operation on the one hand and monopoly on the other."[6]

The view that antitrust has a social goal at least coordinate with its economic goal is not one monopolized by this author. The problem of a possible (although not inevitable) conflict betwen our desire for maximum economic efficiency, on the one hand, and our desire to avoid excessive concentration of economic—and perhaps as a result political—power on the other, has been considered repeatedly by eminent jurists and economists. In one of the first cases to arise under the Sherman Act, Justice Peckham stated:

> . . . trusts may even temporarily, or perhaps permanently, reduce the price of the article traded in or manufactured, by reducing the expense inseparable from the running of many different companies for the same purpose. Trade or commerce under those circumstances may nevertheless be badly and unfortunately restrained by driving out of business the small dealers and worthy men whose lives have been spent therein, and who might be unable to readjust themselves to their altered surroundings. Mere reduction in the price of the commodity dealt in might be dearly paid for by the ruin of such a class, and the absorption of control over one commodity by an all-powerful combination of capital.[7]

Similarly, one of the nation's leading jurists—Judge Learned Hand—pointed out in a landmark antitrust decision:

> We have been speaking only of the economic reasons which forbid monopoly; but, as we have already implied there are others, based upon the belief that great industrial consolidations are inherently undesirable, *regardless of their economic results.* In the debates in Congress Senator Sherman himself . . . showed that

[6] Thorelli, *op. cit. supra* note 3 at 121; also cf. Dirlam and Stelzer, "The Du Pont-General Motors Decision: In the Antitrust Grain," 58 *Columbia Law Review* 24, at 25-26 (1958).

[7] *U. S.* v. *Trans-Missouri Freight Assn.*, 166 U. S. 290 at 323 (1897).

among the purposes of Congress in 1890 was a desire to put an end to great aggregations of capital because of the helplessness of the individual before them. . . . Throughout the history of these statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, *for its own sake and in spite of possible cost,* an organization of industry in small units which can effectively compete with each other.[8]

What these jurists are saying, in essence, is that *even if* the preservation of small, independent businessmen involves a sacrifice of efficiency—and nowhere has such an argument been conclusively proved—such a sacrifice is a small price to pay for the social-political benefits of a society in which economic power is widely diffused. Justice Douglas has, in characteristic fashion, vividly set forth the social costs which must be given weight:

. . . there is the effect on the community when independents are swallowed up by the trusts and entrepreneurs become employees of absentee owners. Then there is a serious loss in citizenship. Local leadership is diluted. He who was a leader in the village becomes dependent on outsiders for his action and policy. Clerks responsible to a superior in a distant place take the place of resident proprietors beholden to no one. These are the prices which the nation pays for the almost ceaseless growth in bigness on the part of industry.[9]

Economists, too, have begun to recognize the folly of relying on some form of economic calculus to determine proper public policy, i.e., a program to maximize efficiency. Would an economist's proof that the organization of German industry in the late 1930's was one which achieved an optimum

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[8] *U. S.* v. *Aluminum Company of America,* 148 F. 2d 416, at 428 and 429 (1945) (emphasis added).

[9] *Standard Oil Company of California et al.* v. *U. S.,* 337 U. S. 293, at 318 (1949).

use of that nation's resources—using the word "optimum" in a strictly economic sense—convince anyone that we ought to encourage similar cartelization? Or would one not be inclined to inquire into the political price paid for this (assumed) economic efficiency?

Thus, Dirlam and Kahn have noted that conflicts between "economic welfare" and other values "are the order of the day. They are resolved pretty much on the assumption that neither one side nor the other invariably takes precedence. The resolution of these conflicts of interest and values is a political, not an economic function."[10] They go on to note:

> Clearly we are not devoted to a competitive system only for 'economic' reasons. It is also associated with such social and political ideals as the diffusion of private power and maximum opportunities for individual self-expression. If the economy will run itself, governmental interference in our daily life is held to a minimum.[11]

And Galbraith has recently expressed in popular form a feeling long-held by many economists—that the standards by which the profession has measured "good" and "bad" may, indeed, now be worse than valueless.[12] Economic considerations cannot be ignored; rather, they must be weighed in the balance with other, non-economic factors.

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10 Dirlam and Kahn, *Fair Competition: The Law and Economics of Antitrust Policy*, 8-9 (1954).

11 *Ibid.*, at 17. For a defense of competition presented primarily in economic terms see Wilcox, *Public Policies Toward Business*, 12 (1955).

12 Galbraith, *The Affluent Society*, passim (1958).

Remarks of James J. Saxon, Comptroller of the Currency, Before the Bond Club of Toledo, Toledo, Ohio, February 9, 1962

Over the nearly a century of its existence the Office of the Comptroller of the Currency, which is the oldest regulatory agency in the Federal Government, has been concerned principally with the basic function of maintaining the solvency and liquidity of our great National Banks throughout the country. Time has brought pervasive changes, however, in the tasks which our National Banks must perform, and these changes have altered significantly the responsibilities of the Comptroller's Office. If our National Banks are to play the role they must in the growth and development of our economy, their operations must be attuned more sensitively to the requirements of today and of the future. The need for a reappraisal of the functioning of our banking system is urgent, and we have made it the first order of business of this Office to re-examine the laws, procedures, policies, and practices which affect these operations.

A week ago we began the first full-scale investigation of our National Banking System which the Office has ever undertaken. Every significant aspect of the operations of our National Banks will come under close scrutiny in the course of this study. We are drawing on the experience of the heads of all the National Banks, and on their thoughts and reflections concerning the problems they have faced, and we anticipate that we shall assemble from these sources the most comprehensive factual evidence that has ever been available concerning the actual functioning of our National Banking System. I have appointed a distinguished group of bankers and lawyers as an Advisory Committee to assist me in appraising this evidence, and in devising measures to meet the problems which are disclosed.

This, however, is only the first step in the adaptation of our National Banking System to the modern economy. This initial study shall be concerned principally with the powers

and functioning of commercial banks. Significant as these surely are, there lie beyond these matters at least two further and vital aspects of our commercial banking system which require the most intensive re-examination.

The first, on which I shall shortly announce an inquiry, concerns the proper role of competition in the field of banking. The banking industry presents unique problems of public policy because, while it is competitive, it is not—nor may it properly be—fully competitive. Banking stands midway between industries such as the public utilities, and those industries in which we rely principally upon the maintenance of essentially unregulated private competition to serve the public interest. It contains elements of both these basically divergent philosophies.

Like the public utilities, entry into banking is controlled by public authority. And there is intimate public supervision of bank lending and investment policies. Unlike the public utilities, however, only certain maximum rates are publicly set for banking services, and the provision of these services is not mandatory. There is thus, within these limits, scope for the exercise of private initiative in the field of banking. This mixture of public regulation and private competition in banking is today a source of uncertainty and dispute.

The issue, put simply, is this: What role should the competitive factors play in the regulated industry of banking? The criteria of the Anti-Trust Statutes do not seem appropriate for the publicly regulated industries. The Anti-Trust Statutes are designed to maintain private rivalry free of explicit public control, where the public depends upon such private competition to serve its needs. Where reliance is placed upon private initiative to make the basic choices concerning investment, output, and prices—as is true in the non-regulated industries—the public authorities stand outside the decision-making process and act merely to sustain

rivalry. To achieve this purpose, it is indispensable that full freedom of entry for new competition should be preserved.

In sharp contrast are the objectives and policies which characterize the public control of banking. The effective functioning of any economy which has advanced beyond the stage where individuals produce solely for their own consumption, requires a reliable monetary medium, and a confidently accepted means of storing and investing savings. To achieve these aims, above any other consideration bank solvency and liquidity must imperatively be assured, and the supply of money and credit must be made responsive to the monetary and fiscal policies of the government. These have always been, and inevitably must be, public functions—and they inescapably entail public control over the entry of new competition in the field of banking. How can the performance of these tasks, which require that the basic decisions be made by the public authorities, be reconciled with the fundamental reliance upon private decisions which is embodied in the philosophy of our anti-trust statutes?

In the current merger cases this basic issue may not specifically be before the courts. These suits rest solely on anti-trust grounds, and the courts thus have no occasion to review the other considerations which the banking agencies must take into account in merger cases. Unfortunately, therefore, the broader public-interest criteria which necessarily guide banking policy are not being faced explicitly by the courts. Judicial review which meets all of the issues cannot be achieved unless means are found to place these broader criteria specifically before the courts.

There are many subordinate problems which grow out of this fundamental issue, and which must be examined. As examples, I would cite these questions: how is the size of banks related to their efficiency; at what point are the cost advantages of size counterbalanced by the limitations over rivalry which result from a reduction in the number of bank competitors; how important a role does the pre-emption of

desirable locations play in the opportunities for new competition to develop in the field of banking; do our present federal and state banking laws inhibit the achievement of the most efficient pattern of banking facilities; what are the proper areas of competition to be considered, and do these vary with the types of banking services offered; what account should be taken of the competition of financial institutions outside the field of commercial banking; should bank holding companies be treated according to the same principles as bank mergers?

Of special concern are the limitations of choice which now hamper the bank supervisory agencies in carrying out their responsibilities to insure that the convenience and needs of the public for banking services are met. Many state laws now limit or prohibit the privileges of branching and of bank holding companies. These state standards seriously impair the discretionary power of the Federal banking authorities. As a result, undue reliance has often had to be placed upon new bank charters, mergers, or holding companies, depending upon the facts in the individual case. Strong pressures are now being mounted to accede to the unnatural use of these devices, without regard to their suitability to the needs of the individual community or area. This course would serve only to fortify these discriminatory inhibitions of the present state and federal statutory structure, and thus obscure its evident and serious weaknesses contrary to the public interest.

The broader the range of choices which are open to the bank supervisory agencies, the more likely it is that the public's needs will be served to best advantage. These needs will vary with the circumstances in individual cases, and the public authorities should have at hand the full complement of tools which may be required. This point cannot be stressed too emphatically. The need was never more urgent to assure the free flow of capital to its best uses throughout the country. Such mobility is indispensable if our economy is to grow and prosper to its full capacity.

The second additional area which I propose to examine intensively is the international role of our commercial banking system. Today, only five of our commercial banks perform a major function in our international trade and commerce, and these are confined to three large metropolitan areas. In most sections of the country, too little attention has been paid to this essential and growing function. All of the evidence points clearly to the fact that in the years ahead we shall have to devote increasing efforts to this field of banking operations.

It is interesting to note that the two most significant developments which have taken place with respect to the international operations of our commercial banks over the past half-century have been the result of post-war developments. After the first World War, we sought to fill the gap in our export trade which had been financed to a significant extent by our governmental aid programs, through the passage of the Edge Act which was designed to broaden the scope of private financing of this trade. Neither the Edge Act, nor the related Agreement Corporations, ever flourished. The outlets for financing facilities within our own domestic economy were so great during the intervening years that, by comparison, foreign opportunities rarely seemed sufficiently attractive.

The reduction in our governmental economic aid programs within recent years has once again brought resort to new measures to stimulate our export trade. Early this week a new plan to deal with this problem was placed in operation. The approach this time is to encourage commercial banks throughout the country to participate more actively in financing our export trade, under the protection of a system of export credit insurance which spreads the risks of such transactions and sets specific costs for meeting these risks. The condition of our international balance of payments has brought this development in our public policy, and our commercial banks must be prepared to adapt their operations to this new task.

The challenge to our imagination and ingenuity, and to our dispassionate concern for the public interest, as we undertake the task of re-appraising our National Banking System, is undeniably great. The hope that, with the help of all who know its problems, it may yet achieve its full potential for the national well-being, is worthy of that challenge.

Statement of Professor Eugene V. Rostow* Before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, Concerning S. 1552, December 7, 1961**

I have examined a good deal of the valuable data this Committee has assembled on the ethical drug industry, as well as the important new data collected by Professors Markham and Fox, and I have reached some conclusions about the Bill as a means to achieve the goal of more active and effective competition, and more rapid progress in this vital industry—both, of course, fundamental purposes of our system of law for governing the economy, and, more particularly. of the patent laws and the antitrust laws.

I strongly approve and support these goals, which are also those the Chairman has in mind in proposing S. 1552. My studies of various industries, and of the functioning of the economy as a whole, have confirmed my belief in the wisdom and importance of the antitrust laws. Competition is the strongest force inducing economic progress any society has yet discovered—the startling economic advance in recent years of the six European nations united in the European Common Market is a dramatic modern instance of the power of competition as an incentive to innovation. Laws to prevent and undo monopolies and restraints of competition make significant contributions to economic welfare, in a variety of ways. The economic case for such laws was summed up in the Report of the Attorney General's Committee, to which I referred a few moments ago, in these terms (at pp. 317-318):

> Generally speaking, economists support competition for four series of reasons, which are of coordinate importance: (1) because the actual level of prices in com-

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* Dean, Yale Law School.

** Except for the introductory paragraphs and biography of the speaker, the statement is printed in full.—Editor

> petitive markets should in the short run more accurately reflect the influence of demand and of cost, and thus in the long run help guide the flow of capital and other resources toward the most productive possible uses; (2) because the goad of competition provides powerful and pervasive incentives for product innovations and product development, and for long-run cost-reduction, both through improved technology and improved management; these forces make themselves felt in the constant process of product variation, and through the pressures implicit in the fact that competitive conditions offer an open opportunity to new entrants in a particular industry; (3) because competitive conditions in business should lead to an equitable diffusion of the resulting real income among consumers and factors of production; and (4) a view held with somewhat less unanimity than the others, because the more flexible prices of competitive markets should make it easier and cheaper for the economy to adjust to industrial fluctuations, and for the Federal Reserve System and the Government to carry through effective contra-cyclical programs of stabilization, primarily utilizing methods of monetary and fiscal policy.

Beyond the economic reasons justifying antitrust legislation, there are political and social considerations of great weight in the public opinion which sustains these laws. They are an influence against undue concentrations of economic power. They help to keep opportunity, and especially entrepreneurial opportunity, open to talent. They are thus one among the many checks and balances in American life through which we seek to achieve and maintain a wide diffusion of authority as the indispensable condition for social and political liberty.

Against this background of my views on the central importance of competition in the American economy, and the American legal system, it is with regret that I must oppose most, but not all of the provisions of S. 1552. I have con-

cluded that these features of the Bill could not effectively serve the ends of competition and economic progress Senator Kefauver has found to justify and indeed to require it. On the contrary, my study of the Bill, and of the available data on the industry, have persuaded me that its most important features would in all probability weaken the existing forces of competition within the industry, and correspondingly increase rather than reduce its present degree of concentration. It would therefore heighten the risk of monopoly or near-monopoly in this extremely important industry, and threaten the promising rate of technological progress which competitive innovation, originating both within and outside the industry, has brought about in recent years.

I

The Structure of the Industry

In order to explain the reasons which have led me to testify against the principal features of S. 1552 today, it might be helpful if I took a few minutes to sketch the general structure of the industry, in broad outline, so as to be quite explicit about the factual predicate of my analysis. I shall not attempt a detailed economic description of the industry, or go into contested issues about its structure and behavior. For present purposes, the evidence brought together in the Committee's Report No. 448 will suffice, with a few additional items, as I shall make clear when I come to them.

The most general problem raised by S. 1552, I should suppose, is whether existing law—the Sherman and Clayton Acts, the patent law, and the Pure Food & Drug statutes—is adequate to protect the various public interests involved in the ethical drug industry. The conclusion of the Committee's Report, and the premise of S. 1552, is that amendments to these laws are needed with particular regard to this industry in order to achieve certain goals of policy which command general assent.

Before these questions can be answered with any assurance, we must agree on the main features of the industry or industries which would be affected by the Bill, and the market or markets in which they function.

Defining the Market

It is now recognized as vital in any antitrust case, at the threshold, to define the market in which the effect of the defendants' conduct on competition is to be appraised. Only when that first question has been answered can a court or an administrative body determine whether the defendant or defendants are monopolizing or attempting to monopolize, or unduly limiting competitive conditions in violation of Section 1 of the Sherman Act, or engaging in conduct whose effect would be substantially to lessen competition or tend to monopoly in violation of various sections of the Clayton Act. The problem before this Committee is very much of this order: to determine whether existing law, viewed as a device for organizing the environment within which the ethical drug industry is conducted, is as effective as possible in encouraging and requiring competition, and in discouraging and preventing monopoly and arrangements of a monopolistic character.

For purposes of this inquiry, what market are we talking about? In other contexts—proceedings against particular companies with respect to the pricing or distribution of particular commodities, for example—it might be proper to define the relevant market as the market for antibiotics, or for broad spectrum antibiotics, or, perhaps, for one particular antibiotic of a distinctive character and quality; and equally, it would be proper to make comparable distinctions in other cases, depending upon the legal question posed by the proceeding, and the range of impact of the defendant or defendants' acts, within the five or six distinct consumers' markets where these products are sold.

But the issues raised by S. 1552 are more general, and I think properly more general. This Bill is addressed to a broad national and indeed international market, consisting of all the firms which now sell or which have the potentiality to make and sell "prescription drugs." This is a market which now includes some 40 classes of products, and at least 22 major firms carrying on business within the United States or participating in the foreign commerce of the United States, as well as over 1200 smaller firms, of which about 140 are members of the Pharmaceutical Manufacturers' Association. About 50 firms are of significant importance in various product markets. Not all the firms compete directly with each of the other firms, and certainly many of the drugs manufactured and sold are non-competitive. But I think the Bill is clearly correct in identifying the relevant market as the entire prescription drug industry, when we look at the problem in the perspective of legislation rather than litigation. The reason for that conclusion is found in the nature of the several technologies on which the industry rests, and in its recent history. It is reasonable to view all these firms, and many more, potentially, as participants or potential participants in a single market, or industry, or "line of commerce," because they are all possible manufacturers of prescription drugs, keenly interested in the opportunities for prescription drug manufacture which the development of scientific knowledge offers them. Not all these firms can or will make all classes of prescription drugs, at any one time, but most of the firms in the industry, and many chemical firms outside it, have the research, manufacturing and marketing capacity to break into the markets for most of the 40 classes of prescription drug products. This fact necessarily exerts a powerful influence on price behavior. As Professor Markham and his group have shown, such entries occur frequently and usually, but not always, through the development of a new product. Moreover, new entrants from other fields have been a common and important feature of this industry—either new firms, large or small, or existing firms

which undertake the manufacture of drugs they have not previously made. Thus, in recent years, Pfizer, Colgate-Palmolive Company, Johnson & Johnson, and Dow Chemical Company have entered the prescription drug industry, and some large industrial companies, such as Schenley, have entered and then discontinued their drug operations.

In most instances, entry into one or another phase of the drug industry is not notably expensive, as compared with the capital cost of entry into other highly technical industries. Neither scientific knowledge nor industrial "know-how" is generally inaccessible to potential entrants—certainly far less inaccessible, broadly speaking, than in the case in many other industries. The greatest economic barrier to entry is the cost of reputation and of distribution—the costs and the time required to convince users of the manufacturer's reliability, and the special costs of informing and reaching the medical profession. But even that barrier is not insuperable, as several instances during the last twenty years attest, and it is negligible for firms which choose to manufacture only and distribute in bulk through other companies.

Industry Characteristics

a. *Number of firms and ease of entry.*

The first notable feature of the drug industry, then, in the perspective of the Committee's problem, is the relatively large number of important firms, as compared with industries like the steel industry or the automobile industry; the comparatively low cost of entering the industry; and the even larger number of potential entrants, who are seeking new drugs, or improvements on new drugs, as their means of entry into this market. It is significant that, according to Professor Markham's study, the top five companies had only 49.1% of the sales of the 33 principal reporting companies in 1951, and that by 1960 the top five had not only changed in composition but had also declined to only 37.7% of the total. It should be noted that these figures overstate

the share of the total market held by the top five companies, since the 33 companies reporting account for only about four-fifths of total industry sales. And in view of the demonstrated ability of the principal drug manufacturing firms to break into the market for most of the 40 classes of prescription drugs, and the equally demonstrated ability of many other industrial companies to do likewise, I cannot draw the inference of undue concentration in several prescription drug markets, as the Committee Report does, from the fact, standing alone, that at a given time those markets are supplied by only a handful of companies. Technological factors, and market factors, may explain the phenomenon, and make it impossible or extremely difficult for more than a few companies to participate in the market, whatever legal rules may be applied—economies of scale in the manufacture of the drug, for example, limited horizons of demand as compared with supply, fear of obsolescence or displacement, and so on. If, for example, a small capital investment of $5,000,000 could establish the capacity to meet the world's needs for prednisone, as testimony quoted in the Committee's Report suggests (page 73), one would hardly expect a rush of many firms to duplicate the capacity of the first entrants into the field, whether the product was patented or not. There are basic economic limits to entry, quite apart from those inherent in the ownership of patents or in other barriers to entry.

b. *Dynamics of Industry.*

The second principal feature of the industry from the point of view of the Committee's problem is its explosive dynamics. The rate of obsolescence of many drugs is high and the risk that a new drug will replace an old one is great. If we look at the largest five firms in each major product class throughout the industry, over a period of ten or twenty years, product by product, we find a pattern of radical shifting, and not one of stability, in the pattern of market leadership. The studies prepared under Professor Markham's

direction bring out this fact clearly. I might mention particularly the recent history of diuretics as an instance of this phenomenon. As shown by Professor Markham's data, this class had four different product leaders between 1951 and 1960. During the same period, there were 27 changes in the market positions of the first five products. Fourteen different products made by eleven different companies were among the five leading sellers at one time or another during the period. During the same period the total market grew by over 2000%.

c. *Rapid Expansion.*

The third major significant element in the industry structure to be noted here is that it is, and has been, an expanding industry. Sales at wholesale of prescription drugs manufactured in this country increased from $200 million in 1939 to about $2 billion today. Total sales of the 51 classes of drugs used for reference in the Committee's Report increased 214% between 1949 and 1960, during a period in which the Gross National Product rose only 95%. These figures represent an increase in volume, and not mere price inflation, since, as Dr. Firestone's studies demonstrate, the weighted wholesale price index for ethical pharmaceuticals has fallen since 1949. Professor Markham has computed that the industry grew between 1947 and 1957 at a compounded annual rate of 9.8% a year, over three times as rapidly as all manufacturing industry. Overall figures of this kind conceal the fact that for many new products—tranquilizers or broad spectrum antibiotics, for example—demand increased very much more rapidly than the rate of increase in demand for the industry as a whole. In products of this kind, there is a typical pattern of extremely rapid increase of demand, as the product is introduced, followed by a slower rate of increase in demand, and then by a stable or falling demand, as new products or new treatment methods tend to limit its use.

d. *Importance of Patents and Trade Names.*

The fourth vital aspect of the industry's structure to to which I should call attention is its recourse to product patents, and the relatively great importance of patents, trade names, trade reputations and trademarks in the patterns of rivalry within the industry. Since many, although by no means all the principal products of the industry are patented, competitive rivalry is concentrated to a significant extent on rivalry with regard to product modification and improvement, and the quest for patents which would permit a rival to enter a promising field despite his competitor's patent.

Pattern of Market Behavior.

What would one expect the competitive behavior of such an industry to be—that is, an expanding industry, consisting of many products, constantly changing in relative importance as the underlying technology changes, with a considerable number of rival firms, and a significant reliance on patents? From the point of view of theory, I suggest that one would expect pretty much the prevailing pattern: that is, a pattern where for each family of related products, the larger part of the supply, after the product has been on the market for a few years, is offered by a rather small number of firms—five, seven or ten, as the case may be; where profits with regard to new products are high, certainly during the period of their successful introduction, when demand outstrips supply, and perhaps thereafter as well, if a patent, as may happen in some cases, gives effective protection against competition; where price leadership is common, and collusion a temptation; and where prices weaken, through discrimination, or otherwise, when capacity begins to match demand, as the rate of increase in supply outstrips the rate of increase of demand, or demand is stabilized, or falls off, as the product is displaced.

This is not, of course, a pattern which corresponds to the model of pure or perfect competition. But it is not a pattern which should occasion much surprise. Nor does it present as many questions about the adequacy of existing law as the structure and behavior of more stable oligopoly industries, where there is far less product competition, and where the entry of new rivals is more difficult, the number of competing firms is smaller, and the list of leaders is more predictable.

Are Prices and Profits Too High?

The Committee's Report, and a good deal of the testimony here, criticizes the industry performance of prices and profits which are deemed to be "too" high.

Indeed, the Chairman's opening statement takes the view that "the principal, though not the only reason for the Bill is that ethical drug prices are generally unreasonable and excessive." I have two comments to make about that arresting statement. The first is that the Committee's Report does not convince me that the charge is valid, and what other evidence I have seen tends to support the contrary conclusion, for an expanding industry like the drug industry. The second point I should like to make is that even if we could agree that drug prices are "too high", by some manageable standard, the Committee Report is static rather than dynamic—that is, it attempts to deal with prices at a moment of time, and not over a period of time; it therefore poses a problem which the whole tradition of the antitrust law regards, and I think rightly regards, as irrelevant.

On the first point—whether drug prices can in fact be considered too high in some sense—Prof. Markham has reviewed the evidence, and I do not wish to burden you with repetitive material. The most appropriate criterion to use in attempting to answer the question is that of company profitability, not profitability for particular products, and

especially particular new products. Company profitability is the only way to judge the combined effect of new and old products, and of research failures and successes. To this question, the Report devotes 14 pages (pp. 48-64), which concentrate largely on data for the years 1957-1959. Material covering longer periods of time do not bear out the conclusions of the Report. For example, the Record of the Hearings before this Committee (R. 10747) would indicate that in the period 1951-1955 ten ethical drug companies tied with two other industries (apparel and accessory chain stores and automobile parts and accessories) for fifth place in a list of 12 industries in return on capital in the period, well below automobiles, aircraft, proprietary drugs and nonferrous metals. To me, the most interesting chart in the Committee's Report is Chart 4 on page 56, presenting FTC and SEC data on profits after taxes between 1947 and 1959. As one would anticipate, the most rapidly expanding industries—drugs and industrial chemicals—were also the most consistently profitable, except for the immediate post-war bulge in motor vehicle profits. Since the demand for industrial chemicals is a function of the rate of investment, the chief variable in the business cycle, it would be natural for the profit rate in that field to drop more than that for drugs during the recession of 1957-1959, as it did. The strength of drug profits may well reflect a factor even more significant than the rate of growth of demand, and the influence of patents: the contribution of intelligent research and development expenses to profitability. A recent article by Professor Yale Brozen of the University of Chicago demonstrates a striking correlation between profitability and research expenditure. The prescription drug industry in recent years has been outstanding in the share of its sales dollar committed to research.

But even if the case were made that one of the most rapidly growing industries of the United States were in fact the most profitable, I should question whether that showing would lead to the conclusion of unreasonable and

excessive prices the Chairman reaches. The practical experience of the Courts and of the Federal Trade Commission with antitrust enforcement over a period of seventy years, as well as the literature of economics, teach us to approach this charge with extreme caution. The prevailing interpretation of the antitrust laws, which I think is entirely sound, makes the "highness" or "lowness" of prices and profits irrelevant for almost all purposes in an antitrust proceeding. The grounds for this position were set out many years ago by Judge Taft in the *Addyston Pipe* case, and restated in 1927 by Mr. Justice Stone in his *Trenton Potteries* opinion.

The reasons which lie behind this position go beyond those of soundness in judicial administration. They are reasons of economic policy as well, as the facts before the Committee in this investigation illustrate. On what grounds can we conclude that the price of tetracycline, for example, is too high? Tetracycline was introduced to the market in 1953 by one company, and in 1954 by four others. The drug was highly regarded by the medical profession as more effective than its predecessors; the demand for it increased rapidly; its use began to affect the demand for other broad spectrum antibiotics, and their prices. The Committee's Report presents some data which purport to show that in 1958 the "computed production cost" of the product was of the order of 10% of its price to the druggist. Without going into the intricacies of the Committee's cost estimates, or other features of what my friend and colleague Walton Hamilton once called "Ordeal by Cost Accounting", I wonder what these figures are supposed to prove.

Prices and Costs

In the most competitive markets we know anything about, the prevailing price at any given moment of time should have no fixed or determinative relation whatever to cost. As Prof. D. H. Robertson once remarked, "to say that price is determined by marginal cost is always bad theory."

The Report takes a position on this question I find hard to understand. Discussing the effect of technological progress, and other cost reductions, on prices, the Report says (page 2):

> "In the past there has been no pressing need to be concerned with this problem. Under the theory of competition, on which our public policy toward industry has been based, the problem simply does not arise. It is assumed that as soon as any firm in a competitive industry makes an improvement which reduces its costs, it will make a corresponding reduction in price."

I can illustrate my difficulty with this argument with a homely example. Suppose there is a wholesale vegetable market in a town, to which farmers and dealers bring their produce. And let's consider the price of tomatoes in that market. Every day, tomatoes arrive, from near and far. Some farmers have richer soil than others. Some are better farmers than others. Some live near by, others must travel long distances. Each seller has different costs. They all receive the same price. If one reduces his costs, through better drainage or cultivation, he hasn't any incentive whatever to reduce his price. He simply takes a higher profit (or quasi-rent) at the market price. Suppose the demand for tomatoes rises—a doctor, perhaps, has published a book contending that tomatoes contain the secret of longevity, or vigor, or better eyesight, or what have you. The price of tomatoes rises, without any regard to costs. More distant farmers and dealers bring their tomatoes to market, so long as the expected price promises to cover their production costs.

There is no reason in the theory of competition on which our law rests to suggest that production costs are or should be the standard of prices at any given moment of time. That theory contemplates prices fixed by demand, with supply responding to the market price. Each supplier or potential supplier offers more goods so long as the expected

market price promises him a return, given his costs. And supplies come forward, as rapidly as they can, until price no longer covers the variable out-of-pocket production costs of the marginal producer.

But that process of adjustment is entirely compatible with the earning of profits, and with prices well above average costs for most of the firms in the industry, or indeed for all of them, at times of strong demand, and experience at times of rising demand.

Prices above average costs for the industry, and profits above profits prevailing elsewhere in the economy, are the signals of a market system attracting more capital to an industry, and enlarging the supply of its products. Existing producers expand their production so long as additional output brings in additional revenue. New producers may enter the field, so long as the revenue they expect promises to yield a return on the capital they are prepared to commit. It is only through adjustments of this kind—through the mobilization of additional capital, or the withdrawal or non-replacement of existing capital, that a market system organizes production so that supply matches demands through time.

Of course in the long run, under competitive conditions in a stable or an expanding industry, prices should fall towards average costs, including a return on capital comparable to that yielded by alternative uses of capital at similar levels of risk in other parts of the economy. The "long-run" in economic theory is the period in which capital can enter or leave an industry, raising or lowering the supply offered at market prices. But it is always dangerous to assume that any given moment is in fact that of long-period equilibrium in any market, when the signals of profit indicate neither the economic value of additional investment in competition with other uses for capital, nor the withdrawal of capital, through the failure to replace it, or, where possible, its transfer to other uses. Only at such a point would it be

proper to contend that profits persistently above those received in other industries, taking differences of risk into account, were evidence of deep-seated monopoly practices, and an indication that the existing law had failed, either in conception or in enforcement.

Certainly there is no reason given in the Report to indicate that 1958 would have been such a moment in the market for tetracycline, a product which had been available for only four years. Even if the product had been sold under conditions of perfect competition, profits from its manufacture would probably have been very high compared to profits on other products, four years after its introduction as an important new product, with demand still growing rapidly. This possibility would have been particularly likely to occur, if, as would seem natural, new entrants required some time to perfect their methods of production, so that there was some lag in capacity as compared with demand.

In this connection, Chart 10 on page 82 of the Report is of particular interest. It shows the bulk prices of streptomycin fluctuating, and falling, between 1951 and 1960, while the price—or at least the price to the druggist—of new broad spectrum antibiotics remained stable. We know from the record and from the Trial Examiner's perceptive opinion in the FTC American Cyanamid proceeding on the subject that the straight line on Chart 10 was something of an illusion, since actual prices in several markets deviated considerably from announced prices, through the giving of free goods and other natural and competitive forms of economic discrimination. The Report, concentrating on the cost side of the market equation, concludes that Chart 10 shows the difference between market determined and administered prices. I do not think that such an inference is warranted from data presented. We would have to know also the total sales of both classes of drugs during the period, and the extent to which the development of broad spectrum antibiotics affected the demand of penicillin and streptomycin. That the price to the druggist of the newer broad spectrum

antibiotics remained stable is hardly remarkable; in fact, especially for tetracycline, one might have well expected a rise. One would hardly expect the druggist to possess the bargaining power of large hospitals or government agencies. And, of course, the druggists often operate under the price protection of fair trade laws.

We know, obviously, that tetracycline was not being sold under conditions of perfect competition, but those of oligopoly, with five sellers, a conflict of patent rights, and a conflict also of trade names and trade reputations addressed to the preferences of physicians and hospital directors. It is possible that the five sellers had a secret understanding as to prices they charged, although an FTC examiner has recently found no such proof. With or without collusion, however, there is no reason of theory or of experience to suppose that the level of prices which actually prevailed in 1958 was in fact higher than that which would have prevailed under conditions of perfect competition. In many instances since the War we have seen the administered prices of oligopoly kept relatively low—sacrificing short run advantage in order to discourage entry—while in more competitive industries prices were driven up by rising demand, until more supply could be found or produced to match it.

In the prescription drug industry, it may well be, considerations of this kind would not influence the pricing policies of an oligopoly group. Each seller may base his business decisions on the premise that only a few among his many costly research efforts will lead to marketable products, and that a long period of life for such products is comparatively rare. He may therefore determine to maximize short-period profits on his rare research success, and let the long-run take care of itself, at least within the limit set by the risk of attracting too many rival entrants. Whichever approach to pricing was pursued, it is hardly remarkable that profits were high, as compared with those in some other industries, in an industry for whose products demand rose 290% between 1947 and 1960, while the total of spend-

ing for all products and services, the Gross National Product, rose 115%. And it speaks well for the degree of competition within the industry that its output doubled in dollar value in ten years, while its overall price level remained stable, and in fact declined appreciably.

Reviewing the industry's structure, taking due account of the importance of patents and the resale price maintenance in the industry's economic life, the number of sellers and potential sellers in its sub-markets, and the instability of its leadership groups, it is difficult for me to conclude that the industry is even near the boundary line between effective competition and cooperative oligopoly.

The Provisions of S. 1552

Senator Kefauver has said that S. 1552 is designed to secure relief from a monopolistic industry by "infusing therein the force of price competition."

Manifestly, it is in the public interest that while profits in an expanding industry be high enough to attract new capital, the pressures of competition be allowed as much impact as possible, taking into account also the important policies represented by the patent laws.

Let me comment, now, on the several provisions of the Bill as means to secure that end.

I approach these questions with a certain bias. Generally speaking, our experience with the antitrust laws predisposes me to be doubtful about particular statutory provisions addressed to the problems of a particular industry. As Judge Loevinger has testified, we have found the most general and adaptable statements in the statutes to be most useful, in permitting the Courts and the administrative agencies to deal flexibly with the changing problems of a dynamic economy. The attempts to amend the Sherman Act to deal with transitory situations in given industries have not been very successful; they have often

given rise to sterile litigation, and have proved generally easier to evade than the fundamental rules of the Sherman and Clayton Acts.

Official Names and Minimum Manufacturing Standards

Given that bias, however, let me say at once that I can see advantages in the idea behind the proposals in S. 1552 about minimum manufacturing standards and standardized official names for drugs, and for requiring simple official names to be prominently printed on labels, as well as trade names. I speak of the idea rather than of the Bill's provisions themselves, since I am not an expert on the drug industry, and I can have no opinion on how much simplification of official names is feasible, or whether existing laws and procedures are adequate to accomplish the objectives of these parts of the Bill.

There is no doubt that in this industry, as in many others, a high cost is incurred by way of advertising and salesmanship. Part of that cost is inevitable and useful, in spreading information about availabilities rapidly to all sectors of the market. While such estimates would be difficult to make, part of these costs may well be wasteful, in attempting to persuade physicians and other consumers of drugs to prefer one source of supply rather than another, on grounds which have nothing to do with the pharmacological differences among products. Doubtless there are pharmacological differences even among products having the same official name, and differences too in the standards of workmanship and care among manufacturers. The goal of regulation or legislation should be to raise manufacturing standards, in the interests of health, and in order to improve the state of knowledge among physicians and other users of prescription drugs about the extent to which rival products are in fact good and effective substitutes for each other.

Standardization of drug names should help to rationalize the physician's choice among genuinely fungible drugs, and

minimize the possible influence of irrational consumer preferences in the market. Such consumer preferences often have price consequences, as Secretary Ribicoff's testimony before you brought out. Insofar as standardization of drug names helps to improve the physician's knowledge of his real alternatives in the market, branded and unbranded, it should help to promote competition, and reduce the burden of possibly wasteful costs of distribution and advertising. This problem has arisen in many other contexts—the classification of bituminous coals is an important example. I favor devices of this kind to broaden the market, and bring substitute products more directly into competition with each other in the minds of the ultimate consumers. Whether this end can best be accomplished by voluntary or governmental action, or by a combination of the two, I express no opinion. I am generally impressed by what Secretary Ribicoff said on the subject (Tr. 1084-1085).

Similarly, regular FDA inspections of manufacturing methods and quality controls in all drug plants should help to remove some unwarranted doubts about the reliability of some sources of supply, and thus serve the same end of broadening the market, and making it more competitive.

Patent and Antitrust Provisions

Secondly, I should like to address myself to the three provisions of the Bill dealing with the status of patent rights in this industry—that requiring compulsory licensing of drug patents after three years; that which would make it more difficult than it is now to obtain patents on so-called molecular modifications; and that which would declare it to be a violation of Section 1 of the Sherman Act for the owners of competing patent applications to settle their conflict by certain kinds of private agreement.

I do not start this part of my analysis with the conviction that our present patent law, and our present antitrust

law dealing with the abuse of patents, are by any means perfect. I recall a meeting of a Committee of the American Law Institute where Judge Learned Hand remarked that one of the strongest impressions he had of his many years on the federal bench was that the patent law had some fundamental defects. His view is supported by a good deal of evidence, including the studies of scholars, and some useful papers prepared for this and other Congressional Committees. We need much more information, and much more research and study about the conditions of creativity of American science, before we can be sure that our patent law, and other arrangements for encouraging and rewarding creativity in science, are in fact adequate and effective. These are problems which go far beyond the drug industry, and indeed far beyond the patent law.

It hardly follows from this state of doubt, however, that I should favor legislation which would drastically alter the forms of patent protection in one industry, and materially reduce the incentives of reward for the inventors of patentable drugs, as compared with other inventors. Here again, I should suppose, as in the case of the antitrust law, the presumption is that the patent law should be uniform and general, and therefore capable of allowing the Patent Office and the Courts to deal with a variety of changing problems over a long period of time. And if it is a case for experiment with the patent law, in reducing the reward it offers for invention and disclosure, there are many reasons against making that experiment in the drug industry, where the risks of failure would be risks to health, and not merely to the rate of economic progress.

Many people think that the invention of drugs should be in a category quite different from other inventions, because of their relation to health. And there are traditions, within the medical profession and the Universities, which oppose recourse to patents in this field. Some countries, notably Italy among the countries of advanced industrial technology, do not issue either product patents or the nearly

equivalent process patents in the field of drugs. Mr. Frost, Dr. Vannevar Bush, and Mr. Connor will discuss these problems before you at length in their relation to the process of progress in science. Suffice it to say here that I am convinced that the case for patents in the field of drugs, as an incentive for research and innovation, seems to me to be particularly strong, and particularly well documented, and I am glad that S. 1552 does not propose that we go so far as to follow the precedent of Italian law in this regard. I do, however, regret the long step which S. 1552 would take in this direction, on the basis of a demonstration I do not find convincing.

Since S. 1552 retains the basic device of the drug patent, although with modifications, as an inducement and reward for invention and disclosure in this industry, I am at a loss to understand the proposals of Section 3, which would impose a higher standard for patents on modifications or combinations of existing drugs than for the original drugs themselves. In the long run, the most important form of competition protected by the Sherman Act is competition among ideas, and among competing patents. Cases like *Standard Oil (Indiana)* v. *United States*, 283 U. S. 163 (1931); *Hartford-Empire Co.* v. *United States*, 324 U. S. 570 (1945); and *United States* v. *National Lead Co.*, 332 U. S. 319 (1947), well illustrate the point I have in mind. Over a period of several generations, technological innovations are the greatest force in an advanced economy making for improvements in the standard and quality of living. We should be at pains, in view of that fact, not to pass laws which could weaken the drive for innovation.

Our legal tradition, greatly influenced in this regard by the experience of our judges with the antitrust laws, is to confine patents narrowly to the scope of the inventor's contribution, and to deny him any protection beyond that given for his invention. We are properly strict, for example, in refusing protection when the patentee attempts to use his patent to gain an advantage with regard to his sale of any

other product or service. And we do not give a patent so broad a sweep as to bar a separate patent to a competitor who invents a useful and unobvious improvement for it.

Once a patent has been issued on a particular new drug which is then marketed commercially—and it is a striking comment on the research process that only one drug patent in ten is in fact so used—why should we wish to impose special standards of difficulty on the issuance of subsequent patents for competing drugs that modify the first one? By doing so, we should be restraining the competition among ideas which it is the purpose of the disclosure provisions of the patent laws, and of the antitrust laws in their relation to patents, to allow free play.

The filing of patent applications serves an important function in that it requires extensive disclosures, which are often stimulating and valuable to the research workers in all parts of the field. If we adopted the Italian rule, we should lose most of this advantage, since companies would seek protection for their ideas as trade secrets, and would make only the lesser disclosures required by the Food, Drug and Cosmetic Act, before new drugs can be marketed. Once the disclosures of a patent application have been made, research workers everywhere have an incentive to pursue the line of inquiry thus revealed. The more important the drug promises to be, the more incentive they have to seek its improvement. From the medical standpoint, as the testimony of others will develop, product modifications and combinations have been among the most important advances in drug manufacture. As a university man, accustomed to the endless conflict of ideas, I abhor the notion of an official committee, however distinguished, passing on the utility of an innovation in advance of experience. From the point of view of competition in the industry, modifications have been and are of equal or even greater importance. To restrict the possibility of obtaining modification or combination patents, by imposing a special standard for those patents, would reduce the incentive to develop a product which could compete

at least on equal terms with the patent issued. It would make the first patent in a field more valuable as a monopoly than is now the case in most instances, and reduce the intensity of competition among patents. In the interest of competition in this industry, the case against the modification and combination patent features of the Bill is just as strong as the case against it from the point of view of research and progress in the useful arts. Of course the Patent Office should not issue patents on modifications or combinations only for the sake of reducing the value of the prior patent. But why should we require more, by way of a showing of therapeutic utility, in the one case than the other? I have concluded that the proposal is at war with the basic purposes the Chairman has announced as those of the Bill.

Compulsory Licensing

What of the case for Section 3(c) of the Bill, providing a special date of effectiveness for future drug patents, as distinguished from all other patents, and requiring compulsory licensing at specified royalties three years after the new effective date? Other witnesses will speak of this provision of the Bill from the point of view of the patent law, and the research procedures of the drug industry. I shall confine my observations to the desirability, as a matter of legal policy towards competition, of providing a special rule of compulsory licensing for this industry.

The purpose of this provision, the Chairman has explained, is to reduce the profits of the patent holder in the interest of encouraging more entrants into the market for each patented product, and thus more competition through lower prices.

Compulsory licensing, with or without reasonable royalties, is a familiar remedy in the antitrust laws, required in many cases where patent monopolies have been converted into industry monopolies in violation of the Sherman Act.

The utility of the remedy in such situations, however, is not a reason for adopting it as a general rule, in the absence of a persuasive showing that the prescription drug industry is in fact a well organized and effective monopolistic conspiracy, using patents to bind together the monopolistic group. The Committee's Report makes no such claim, as I read it, and the evidence it summarizes would permit no such inference.

The difficulty I find in the proposal, taken into conjunction with those of Sections 3(a) and 3(b), is that it might well fail in both its objectives of encouraging more entrants, and of stimulating more vigorous price competition. The reasons which lead me to this conclusion derive from the structure and dynamics of the industry, where competition in developing new products has been of such fundamental importance in recent years. As to price competition, I am inclined to think that competitors using rival patents are likely to be more aggressive with regard to price than licensees, even if the last vestiges of *United States* v. *General Electric Co.*, 272 U. S. 476 (1926), were soon to disappear.

But would there be many more entrants into each field in a regime of compulsory licensing after three years?

The first question to be answered is whether Section 3(c) would so reduce incentives for research and development, and for patenting the results of research and development, as to diminish the number of patents which would be subject to compulsory licensing, and the number of qualified firms capable of using such licenses. How many firms would be willing to bear the cost of the many research failures that usually accompany a single research success, if the period of patent protection were so drastically reduced?

The disincentives for research under such a rule would be heightened by the apparent attractiveness of the policy of taking a free ride by way of compulsory license on whatever patented new products might come out of the research programs of others. It would not even be necessary to wait

three years before starting on such a free ride, given the usual hazards of patent litigation. An infringement suit would not normally be completed within a three-year period. And even if the patent were upheld, the most probable risk of infringement would be to pay a retroactive royalty. But without continued competition in research, new product competition would slow up, the flow of new products would be arrested, and the pattern of expansion which has dominated this industry since the War fundamentally altered. After a period of adjustment in which many firms might try their hands at producing products under compulsory licenses, the market position of each firm would be determined, in a stable or declining market, primarily by the efficiency and capacity of its manufacturing and distribution facilities, and by its reputation for quality with physicians.

The race between actual supply and potential demand at expected prices is in all industrial situations the ultimate deterrent to entry, even where patents are not involved. It is the underlying economic reason why most drug markets today do not have more than 5-10 sellers, whether the product is patented or not. Under the circumstances which seem reasonably predictable were S. 1552 to pass, with a diminished flow of new products, and a less active market, it seems fair to conclude that the larger firms would dominate the market more completely than is the case today, and the trend would be towards a stable oligopoly, or a series of stable and co-operative oligopolies, more powerful and dangerous than any we have yet seen in this industry. The opportunity for entry in the industry today is in large part a function of its rate of growth, which in turn is greatly influenced by the flow of new products, most of them patented.

There are cases the Committee has discussed where there is a sense of natural outrage at the thought that a patent holder might be the sole supplier for a 17 year period of a drug of peculiar importance. The case of insulin comes to mind, or of some other drugs of far-reaching significance. From the point of view of the policies which animate the

patent law, there can hardly be less protection for an invention of genius than for run-of-the-mill inventions of transitory importance. Such cases are exceedingly rare—that is, instances of inventions which in fact carried with them the command of entire markets or industries. If such command results from the combination of competing or even complementary patents, existing antitrust doctrine would condemn it out of hand under the Sherman Act. What of the extreme and thus far largely hypothetical case, of a single patent which created a new field, and proved invulnerable over an extended period of time to the attrition of competing or modification patents?

In all the previous experience of the drug industry, situations of this general order have been met in fact by the patent holder voluntarily licensing more than one supplier. This was the case with insulin, cortisone, streptomycin, and meprobamate, and with some other drugs of unique value. Suppose, however, that another line were pursued, and the patent holder proceeded to exploit the highly inelastic demand curve for his product in a very enthusiastic way?

In the first place, the Government would always have the option of mitigating the effects of the practice by having the product produced under Government contract. In the hypothetical case I have suggested, this could be done under the existing provisions of 28 U. S. C. 1498, with royalty payments to the patent holder fixed by the Court of Claims. In the second place, for cases of this kind, the recommendations of the first Report of the National Patent Planning Commission in 1943 might be seriously considered. That Report recommended procedures for requiring compulsory licensing of any patent where a determination was made by an independent body that the national defense, the public health, or the public safety required such action, and then only to the extent the remedy was required by such findings.

The difficulty with the compulsory licensing feature of S. 1552 is that it is indiscriminate. By subjecting all future

drug patents to compulsory licensing, regardless of how well the patent holder has met the public's need, it goes far beyond the recommendations of the Patent Planning Commission's Report. It would therefore gravely reduce the incentive effect of the patent system in stimulating research and experiment in this field, where research and experiment have been expensive, technical, and risky. I cannot see any justification for such a rule in the drug industry, or for any other that I know about.

Antitrust Amendment Barring Private Settlement of Patent Interferences

Finally, I should like to add a word about Section 2 of the Bill, which would make certain kinds of agreements among the holders of competing patent claims illegal per se under Section 1 of the Sherman Act.

The objection to this provision is best stated in Justice Brandeis' opinion in *Standard Oil Co. (Indiana)* v. *United States,* 283 U. S. 163 (1931), still the leading opinion in the field. That case, you will recall, concerned the legality under the Sherman Act of a series of 79 contracts cross-licensing four competing patents for the cracking of petroleum in the manufacture of gasoline. Both interference proceedings and infringement suits had been begun. The Courts' opinion examined the effect of the contracts on the competition among cracking processes for the manufacture of gasoline, and on competition in the production of cracked and of ordinary gasoline. Finding no substantial restraint of competition in any one of these three markets, the Court found for the defendants. The court made it clear that the law favors the settlement of conflicting claims by agreement rather than litigation, in this as in other fields, where the settlement would threaten no undue limitation of competition conditions in any market where the defendant's influence was felt. Under some circumstances, the court comments, such agreements may promote rather than restrain competition.

Making all private settlements of patent conflicts illegal per se under the Sherman Act could hardly serve the broad purposes of that statute. Surely cross-licensing and pooling agreements have been used as the cloak for antitrust violations, and when so used they should be dealt with, in this as in other industries, under a doctrine which is now altogether adequate for the purpose. There is a special reason for strictness in dealing with such cases, since there is always an inherent risk of broadening the monopoly conferred by the patent. There is no evidence that I have seen indicating that patent pooling arrangements are more common, or more dangerous, in the drug industry than in other industries where patents are important. And equally surely, many settlements of patent conflicts which would be reached by this provision could have no significant effect on competition at all, in any relevant market. I can see no reason why the law should force litigation to the end in all instances of patent conflict, however flimsy the contentions of the parties may be. In many cases, such a rule would reduce the pressure of competition, by requiring the holder of the weaker claim to refrain altogether from producing the product, rather than take his chances in interference proceedings or infringement suits. The customary alternative—a cross-licensing contract—seems preferable, from the point of view of competition, as it does from that of the old policy of the law which favors the peaceful settlement of disputes. On this point, as on several others, I am impressed by the carefully phrased testimony of Judge Loevinger, the Assistant Attorney General in charge of the Antitrust Division.

Conclusion

The Committee is to be commended for its pioneering efforts to explore the extremely difficult and important problems of administered prices in the economy. Its Hearings, studies and Reports in this field are a mine of information and of ideas. Whether existing law is as adequate to deal with the modern problem of oligopoly as it proved to be in

dealing with the single firm monopolies of the 1890's is a question of fundamental significance, and gravity.

With regard to the prescription drug industry dealt with in S. 1552, I find the proposed cure more dangerous than the condition it undertakes to remedy. The industry is producing new products of great public value, the level of concentration is relatively low, compared to that in some other industries, the entry of new firms is relatively easy, market positions shift frequently, price levels for the industry as a whole do not rise, and profit levels, while high, do not seem so high or so stable, in an expanding industry, as to constitute reliable badges of genuine monopoly power. Steps can and should be taken to remove imperfections of knowledge among consumers as to the availability of reliable substitutes, and thus broaden the market. Otherwise, I should not class this industry as among the more acute problems of oligopoly our public policy now confronts.

The remedies proposed in S. 1552 might well slow down the pace of innovation and expansion, and therefore tend to reduce the number of firms through time—precisely the opposite of the result sought by the Bill.

I should prefer to approach the problems of oligopoly case by case, in this as in other industries, through vigorous and imaginative enforcement procedures which used, and sought to develop, the existing arsenal of accepted doctrines under the antitrust law.

* * * * *

Before the

FEDERAL COMMUNICATIONS COMMISSION

Washington 25, D. C.

In the Matter of

Pending License Renewal Applications:

WBZ, Boston, Mass.	— BR-202
KYW, Cleveland, Ohio	— BR-286
WOWO, Ft. Wayne, Ind.	— BR-492
KEX, Portland, Ore.	— BR-93
WIND, Chicago, Ill.	— BR-708
KDKA, Pittsburgh, Pa.	— BR-338
KDA-FM, Pittsburgh, Pa.	— BRH-20
KEX-FM, Portland, Ore.	— BRH-694
KYW-FM, Cleveland, Ohio	— BRH-437
WBZ-FM, Boston, Mass.	— BRH-857
WBZ-TV, Boston, Mass.	— BRCT-103
KYW-TV, Cleveland, Ohio	— BRCT-88
KDKA-TV, Pittsburgh, Pa.	— BRCT-99
WJZ-TV, Baltimore, Md.	— BRCT-14

Westinghouse Broadcasting Company, Inc.

Westinghouse Broadcasting Company, Inc. (Cal.)

Westinghouse Broadcasting Company, Inc. (Md.)

Memorandum Opinion

By the Commission:

Chairman Minow concurring in part and dissenting in part and issuing a statement; Commissioner Bartley dissenting and issuing a statement; Commissioner Ford concurring and issuing a statement.

1. The Commission has been examining into applications by broadcast subsidiaries of Westinghouse Electric Corpora-

tion for renewal of the licenses for the stations listed above. Westinghouse was early last year convicted for criminal conduct in fixing prices and rigging bids on sales of electrical equipment. In assessing qualification to operate a broadcast station, the Commission has customarily taken into account the character and conduct of the applicant, including any record of non-observance of the law no matter how and where recorded. The Commission has withheld action on the pending applications during a period of intensive examination into the problem of the effect, if any to be given these convictions. Interrogatories addressed by the Commission on November 1, 1961 have produced a complete showing on the broadcast performance of the Westinghouse stations during the past license period and have verified the details of the working relationship established by Westinghouse for its broadcast subsidiary corporations to assure parent company responsibility for the broadcast operations.

2. In nineteen criminal prosecutions terminated early in 1961 in Philadelphia, Westinghouse and a number of its employees were among the defendants to indictments charging conspiracies to fix prices, rig bids, and divide markets on electrical equipment valued at $1,750,000,000 annually. The product lines involved were power transformers, power switchgear assemblies, turbine generator units, industrial control equipment, power switching equipment, condensers, distribution transformers, oil circuit breakers, low voltage power circuit breakers, low voltage distribution equipment, watt-hour meters, power capacitors, lightning arresters, instrument transformers, network transformers, bushings, isolated phase bus, navy and marine switchgear, and open fuse cutouts. Westinghouse paid $372,500 in fines. It pleaded "guilty" in seven cases, "*nolo*" in twelve. Eleven of its employees were involved as defendants. All were fined, seven drew prison sentences, and two were in fact jailed. Civil actions flowing from these proceedings have been instituted by the Government seeking restraining orders and damages, and substantial amounts are also sought in various suits

brought by utilities, state and municipal bodies, and by others claiming injury.

3. The prosecuting Attorney-General characterized the proceedings as involving "as serious instances of bid-rigging and price fixing as have been charged in the more than half century life of the Sherman Act"; the presiding judge, in imposing sentence, observed that the conduct of the corporate and individual defendants had "flagrantly mocked the image of that economic system of free enterprise which we profess . . .". Under the terms of Section 313 of the Communications Act, revocation of the Westinghouse licenses was available to the court in the criminal antitrust proceedings, but this sanction was neither sought nor imposed and is not contemplated by the civil actions now pending.

4. Westinghouse, through wholly-owned subsidiaries, operates AM, FM, and television stations as the KDKAs in Pittsburgh, the WBZs in Boston, the KYWs in Cleveland, AM station KEX and station KEX-FM in Portland, Oregon, AM stations WBZA in Springfield, Mass., WOWO in Fort Wayne, Ind., WIND, Chicago, Ill., and television stations KPIX in San Francisco and WJZ-TV in Baltimore, Maryland. The antitrust conduct was involved in a product group which comes up an organizational line different from that controlling the operation of the broadcast stations. The indicted activities were in Apparatus Products which was subdivided into four product divisions. The highest placed official indicted and sentenced was at the divisional vice-president level, three organizational tiers below the President's office. The broadcast subsidiaries have their own officers and boards, and are operated at an organizational level two tiers below the office of the President of the parent corporation. The president of the broadcast companies is a broadcast man and has no other responsibilities in the electric company. There is no horizontal interconnection, except for top management, between operating divisions supervised by different group officers. The broadcast operations and personnel were not involved in the antitrust cases; there was no demonstra-

tion in the Philadelphia proceedings of criminal involvement by top management of the parent company.

5. Operation of broadcast stations by Westinghouse dates back to 1920 when KDKA began regular commercial broadcasting. The licenses for its various broadcast stations have, with only minor problems dotting their extensive record, been regularly renewed. Pending renewal applications, which review operations for the preceding 3-year license period, and recent financial reports to the Commission reveal the following: Westinghouse devotes to programming a larger percentage of total broadcast expenses than the average for the broadcasting industry generally. Overall programming shows balance, with some programs in every renewal form category by type. Promise in preceding applications for renewal has been substantially realized in the record offered for examination. But the inquiry has gone beyond conventional processing and marks the Westinghouse broadcast performance as uncommonly good.

6. The Westinghouse broadcast organization appears to be concerned with the quality of programming available from usual industry sources and makes a substantial effort to encourage the creative talent of its total manpower pool to the development of a new source of programs for its stations. These group projects have in recent years turned out such program series as The American Civil War, The American Forum of the Air, Youth Wants to Know, Assignment—Nehru, Reading Out Loud, Face of the World, Man and His Problems, Assignment: Hong Kong, etc. Additionally, individual Westinghouse stations produce local programs which are available to others, some recent offerings including Integration at Front Royal, NEA Roundtable, Science Special, Anne Frank, Atomic Year 17, Africa: Giant at the Door, Echo of the Dark Years, As Others See Us, Bowl of Darkness, Tomorrow's Learning Today, etc. All Westinghouse stations editorialize, during 1958-1961 more than 750 times. The ground rules developed for station guidance indicate a serious and mature corporate attitude toward the significance

of the practice. For example, the news staff is separated from any of the editorial activities of a particular station; editorials are handled on a local basis as dictated by the needs and interests of the communities where Westinghouse stations are located; partisan politics are considered not available for editorializing; every editorial is to be clearly labeled and, by placement in a program schedule, insulated from news; every station is required to be prepared to demonstrate fairness in the presentation of opposing views on controversial issues. The Westinghouse stations are significantly oriented to news and public affairs. A policy manual provides that news may not "be influenced by advertisers, or other relationships, corporate or personal". Commission inquiry into news treatment of the Westinghouse involvement in the Philadelphia antitrust cases establishes from the news copy and from the frequency of offerings that the stations gave extensive coverage. In Pittsburgh, for example, the Westinghouse radio and television stations carried 173 different newscasts covering the subject, in Cleveland 235 such items. The news department at a Westinghouse station has available to it, in addition to the usual wire and network news services, the facilities—not ordinarily found in a non-network entity—of a Washington News Bureau and of a European News Bureau, both separately maintained by Westinghouse. Written standards which prescribe for each station minimum amounts of educational programs establish that in this area broadcast responsibilities to local educational organizations form a recognizable aspect of serious local program planning. Westinghouse policy is to carry all of the network-produced public service programs, except where there is conflict with a local public service program of a similar type. Station management is required to become involved and rooted in local community affairs. The extent of local involvement may perhaps be measured by the statistics in one market, for example, where the management officials of a Westinghouse radio and television operation are claimed to be meaningfully involved in eight political clubs, twenty cultural organizations, three

scientific societies, 20 different educational organizations, twenty-seven business and professional groups, sixteen youth organizations, ten military groups, seven women's clubs, twenty-two separate charitable activities, and twenty-seven social clubs.

7. Westinghouse has a long history of antitrust involvement. The governing rule as to the significance of antitrust activities by a broadcast applicant is stated in the Commission's Report issued March 28, 1951, in Docket 9672, which established a uniform policy to be applied to applicants who have a record of antitrust or other law violations. There, the Commission announced that misconduct outside the broadcast field would be weighed against an applicant in determining qualification to hold a broadcast authorization. It was agreed that each case would require separate appraisal, but that recent, recurring, wilful offenses would count more heavily than if the conduct were remote, isolated, or inadvertent. The policy was not designed to formulate additional penalty for illegal non-broadcast conduct. It did announce that behavior in other fields is a relevant circumstance to be weighed in measuring suitability for the public responsibilities involved in station operation.

8. The Commission's concern with the meaning of this policy in relation to Westinghouse punctuates broadcast history. In 1952, for example, shortly after its "uniform policy" had been formulated, the Commission considered Westinghouse renewal applications which had been held up while the antitrust background of the company was being looked into. The Commission granted all the applications without hearing—being persuaded that the longtime, worthwhile broadcast record nullified any suspicion, arising from antitrust behavior in other fields, that Westinghouse might not continue to operate its broadcast facilities in the public interest. In 1955, the Commission again had occasion to examine the monopoly behavior of Westinghouse as it bore on its new station application for Channel 8 in Portland, Oregon (10 R. R. 878). A grant was made to the competing

applicant, but only on its superior showing over Westinghouse on such factors as integration of ownership and management, local residence, and civic participation of stockholders. Westinghouse was, in fact, given favorable consideration for its "long history of successful operation of radio and television stations."

9. Top management of Westinghouse Electric pleads unawareness of the misconduct involved in the Philadelphia cases and appears to be urgently concerned with the impact upon the corporate image of the disclosures of criminality. Westinghouse admits corporate responsibility for something less than maximum management watchfulness. Internal education and surveillance were company policy before the Philadelphia cases developed and new programs have been instituted which it is promised will be vigorously pursued.

10. Control over broadcasting operations is fixed, as follows: The station licenses are held by subsidiary corporations—Westinghouse Broadcasting Company, Inc., Westinghouse Broadcasting Company, Inc. (Cal.), Westinghouse Broadcasting Company, Inc. (Md.). Westinghouse Electric seats three principal officers—its President, Chairman, and Executive Vice-President—on the Boards of Directors of the broadcasting companies. The Westinghouse Executive Vice-President is Chairman of the Boards of the broadcasting subsidiaries. The President of the broadcasting companies is a "broadcast man" without "electric company" responsibilities. Monthly, detailed summaries of station activities are furnished all members of the boards of the broadcasting companies in connection with monthly board meetings. There is frequent and close liaison between the broadcast company president and the executive vice-president of the parent company. The latter makes annual presentations on broadcast matters to the Westinghouse Electric Board of Directors. Information otherwise flows between managements of Westinghouse Electric and of the broadcast subsidiaries through exchanges of personal visits, company meetings, and conventions.

11. Having deliberated at considerable length, we are moved to leave undisturbed the broadcast status of Westinghouse. Our conclusion flows from the considerations stated in the paragraphs which follow:

12. Licensing is prospective—it enables future conduct. In discharging its licensing function, the Commission puts the public interest out at risk, since the issuance of an authorization entails at best only an estimate of the likelihood that performance under the license will be worthy. In aid of the forecasting process, the application for authorization searches out an applicant's background for clues as to risks and for evidence as to expectable performance. Any conduct of an applicant may be said to be probative and meaningful which illuminates the likelihood of prospective conduct and the character of probable performance in the broadcast field. It is reasonable, therefore, for the Commission to look to conduct in other fields in order to search out relevant attitudes and propensities. Involvement in lawbreaking in any area of activity may fairly be taken to indicate an uncertain quality or circumstance, the hazard of which need not be assumed when desirable facilities are to be awarded.

13. This is basically what the Commission's "uniform policy" of 1951 is all about. There the Commission said that its "authority to consider violations of Federal laws . . . is well established and that a positive duty is imposed . . . to exercise this authority." It went on to note that "if an applicant is or has been involved in unlawful practices, an analysis of the substance of these practices must be made to determine their relevance and weight . . . " Violations of the antitrust laws, it was felt, "raise sufficient question regarding character to merit further examination." But this doubt could be overcome by countervailing circumstances. "There may be facts which are in extenuation of the violations of law. Or, there may be other favorable facts and considerations that outweigh the record of unlawful conduct and qualify the applicant to operate a station in the public interest." Recent, recurring, or wilful offenses would count more heavily

in the appraisal than if the conduct were remote, isolated, or inadvertent. Against this background, the convictions of Westinghouse in Philadelphia counter its qualification to hold Commission authorizations.

14. On the other hand, past violation of the antitrust laws is not an absolutely disqualifying fact. It is a circumstance from which the Commission may draw inferences as to future probabilities. The Commission's deliberative process in these cases is designed to uncover and measure risk. It is appropriate, in the circumstances of this case, that we consider all past conduct, both favorable and unfavorable. See *Report on Uniform Policy, supra,* at p. 91:498.

15. Westinghouse has a 40-year record of broadcast service, but we do not place primary reliance upon the length of this record. What is critical, in our view, is the superior and uncommon nature of the Westinghouse broadcast record. We have presented only a skeletal version of this record in pars. 5-6. But examination of the full Westinghouse submission demonstrates that it has made an outstanding contribution to the public interest in the broadcast field, both in local service and in the development of programs which have been made available to many other stations. This latter fact is uncommon and merits special commendation. Its extensive and "in depth" news coverage and its excellent efforts in the production of local programs, often on controversial subjects, are further indications of Westinghouse's superior past record. We conclude, upon examination of Westinghouse's voluminous record, that its operation has been an outstanding and long-standing service in the public interest.

16. We are thus faced with a difficult choice between two conflicting considerations—a most serious reflection on applicants' character and a most convincing showing of excellent service of long duration in the public interest. If our function were to impose additional punishment for such gross violations, the decision would be easy. But that is not our function. The Commission's responsibility is the public

interest in the broadcast field. We have balanced the two considerations in the light of this responsibility and have determined to resolve the conflict in favor of renewal because of the outstanding nature of Westinghouse's contribution to the public interest in broadcasting. We find, therefore, that the broadcast record of Westinghouse does constitute sufficient "countervailing circumstances" to warrant renewal of license.

17. However, in granting renewals, we wish to make clear our views concerning Westinghouse's history of antitrust violations. That history has been previously noted by the Commission. See *Westinghouse Radio Stations, Inc.*, 10 Pike & Fischer, R. R. 878, 911-913. Possibly because of this history, Westinghouse undertook to insure operation fully consistent with the antitrust laws. In its statement to this Commission, Westinghouse stressed its past efforts to avoid antitrust involvement, as follows:

> "... Early in 1947 Mr. Price designated Mr. Huggins ... a lawyer who had had eight years of practice as an associate of a large New York law firm ... to act as Mr. Price's assistant in assuring compliance with the antitrust laws. He and others reviewed the commercial practices ... conducted a widespread educational campaign ... visited ... plants ... Sales Offices ... to advise them concerning current interpretations of the antitrust laws ..."

Yet in 1961, after years of these "educational" efforts, Westinghouse was found guilty of one of the most serious and widespread violations of the antitrust laws in the entire half-century of their existence.

18. Westinghouse has now embarked on a new compliance program. Its President described the program as follows:

> "... In February, 1960, I addressed the Westinghouse Management Council, which includes all officers and

division managers, on the subject of compliance with the laws. I read to this meeting a new corporate Management Guide which restated and reaffirmed the Company's policy on lawful and ethical conduct . . . Also at this meeting I charged every manager present with the responsibility for personally getting this message across to every level of management under him . . . Our educational program . . . stepped up. The Law Department . . . directed to establish regular symposiums reaching every individual having pricing or marketing responsibilities . . . I personally have addressed on at least four different occasions so far in 1961 more than 200 key management people on the subject . . . In June, 1960, we issued an internal letter stating clearly that it is Westinghouse policy to establish prices . . . independently . . . We established a system of certificates, and affidavits, which requires any person who attends any meeting . . . (with) competitors to certify that there was no discussion relating to prices. Department or division managers are required to report quarterly, certifying that they have investigated all prices currently in effect . . . A certificate . . . added to cover telephone conversations . . . Establishment of Antitrust Section within our Law Department . . . Too many industry meetings . . . being held at resort centers and places where the facilities are primarily for recreational and social purposes . . . I have established corporate policy . . . that association meetings be held at the headquarters of the association or in readily accessible, centrally located cities . . . Something else . . . necessary. What we needed finally, I decided, was an independent review . . . We have created a Board of Advice to review our procedures . . . Invited to serve . . . Dean Erwin N. Griswold, of the Harvard Law School; Professor S. Chesterfield Oppenheim of the Michigan Law School; Dean Eugene V. Rostow of the Yale Law School; and Dr. A. D. H. Kaplan of the Brookings Institution."

19. We have set out this background at such length for this reason: If—after having made such assurances which turned out to be ineffectual in 1961—Westinghouse again engages in such significant, widespread antitrust violations, in spite of the above-described new programs and new assurances, then obviously a grave question would arise whether Westinghouse's most important and most seriously undertaken commitments can be credited. The judgment for renewal reached in par. 16 would have to be reevaluated in the light of this serious question, as it bears on the total situation as it may then obtain. In short, the commitments as to compliance with antitrust laws which these applicants have made in connection with their renewal applications are not just commitments to the public, the Congress, the courts, or the Department of Justice. We regard them as commitments to this Commission also, which must be faithfully discharged.

20. For the foregoing reasons, we have determined to issue license renewals on the applications of Westinghouse. We are not extending this treatment to station WBZA in Springfield, Mass., which is the subject of other questions not related to the inquiry here. The licenses which we here approve are not permanent—in fact many of them will run for less than the normal renewal period because of the unusual length of time required for their processing. If the anti-competitive activities of Westinghouse are later found to have extended into their broadcast operations, or if any other material change in the factors here discussed should develop (see par. 19), appropriate action with respect to these broadcast authorizations can be taken at a later time.

FEDERAL COMMUNICATIONS COMMISSION*

BEN F. WAPLE
Acting Secretary

Adopted: February 28, 1962
Released: February 28, 1962

* See attached statement of Chairman Minow.
See attached statement of Commissioner Bartley.
See attached statement of Commissioner Ford.

Statement of Chairman Minow, Concurring in Part and Dissenting in Part

I agree that the broadcasting station licenses now held by the Westinghouse Broadcasting Company should be renewed. But I would vote to renew them for a period of 12 months and then take another look at performance.

We face a fundamental problem of corporate schizophrenia: a large respected American corporation found guilty of serious crimes in a non-broadcast area of activity, yet possessing a solid record of broadcasting in the public interest.

What should this Commission do with this perplexing situation?

The grant of a broadcasting license confers use of a scarce, precious medium of public communication and imposes corresponding responsibilities to the public of the highest importance. The regulatory plan designed by the Congress to ensure the proper discharge of those responsibilities does not and—as a practical matter—cannot rest upon close and constant surveillance of the licensee's day-to-day activities. Nor should it; we properly place great reliance in the character and judgment of our licensees.

The corollary, however, is that care must be exercised in the selection of those who are given such positions of trust. Since anti-competitive conduct is difficult to uncover and even harder to eradicate, this Commission said in 1951 that "only those persons should be licensed who can be relied upon to operate in the public interest and not engage in monopolistic practices." FCC *Uniform Policy as to Violations by an Applicant of Laws of the U. S.,* 1 Pike & Fischer, R. R. (Part Three), p. 91: 495, 500 (1951).

The corporate parent of Westinghouse Broadcasting has been found guilty of participation in a series of the most wide-ranging conspiracies to set prices, rig bids and divide markets ever prosecuted under the antitrust laws. These

crimes involved the deliberate deception of the corporation's customers, including Federal, State and municipal governments and numerous public utilities. All of these were led to believe that bidding upon expensive and vitally important pieces of electronic equipment was free, open and competitive, when in fact it was tightly controlled by agreement among the supposed competitors.

In contrast, we have no indication of similar conduct in broadcasting by Westinghouse. To the contrary, the voluminous record before us amply confirms the widely held opinion that, in its devotion to public service in broadcasting, Westinghouse has few peers and no superiors. As an illustrative instance, the television service which Westinghouse Broadcasting creates for its own stations and makes available to others is—when compared to the efforts of most station licensees in this field—quite remarkable in scope and character.

So our problem is not easy.

The Westinghouse which has performed so capably in broadcasting cannot be divorced from its own parent. Indeed, Westinghouse Broadcasting's parent is as eager to take credit for its subsidiary's broadcasting record as it is to disclaim knowledge of its employees' practices in selling heavy electrical equipment.

At root, the questions which these renewal applications pose turn on the meaning of licensee responsibility in the case of a large, publicly held corporation operating different businesses. We can draw little comfort from the character of those who operate such a company's broadcasting stations if the actions of their superiors in non-broadcasting fields show them to be basically unreliable. It will not do to shelter behind a broadcasting record which has thus far been excellent if that record is not really indicative of the manner in which those who control the licensee prefer to operate. On the other hand, we cannot rely on the fact that top management is innocent of active wrong-doing if that innocence is

the result of a general and across-the-board policy of abdicating responsibility to subordinates. An organization which operates in this fashion is responsible to no one; its good conduct in one field is as accidental as its bad conduct in another.

I believe that the structure of the large modern corporation can be kept compatible with definite personal responsibility. I do not believe that the public interest demands a limitation of broadcasting licenses to individuals and organizations whose sole activity is in broadcasting. The public would be the poorer if this Commission were to be doctrinaire and attempt to prescribe a theoretically pure and proper organization for all of its 5000 broadcast licensees.

What we should do is insist that those responsible to stockholders for a licensee's financial health also be responsible for the licensee's broadcasting. It would be unnecessary and unwise to require that the ultimate principals of every corporate licensee actively manage the corporation's stations. But licensee responsibility cannot be discharged simply by delegation to subordinates, combined with the promulgation of "paper" policies and the reading of year-end financial reports; and it cannot be permitted to evaporate somewhere in the tiers of the corporate organizational structure.

Applying these tests, the extent to which Westinghouse's top management was responsible for the conspiracies of which the corporation stands convicted is not entirely clear. There is no evidence in the public record of the antitrust proceedings that officials of the highest corporate levels actively participated in or ratified the conduct of their subordinates. Yet the Federal district judge observed, in passing sentence upon the corporation, that "one would be most naive indeed to believe that these violations of law, so long persisted in, affecting so large a segment of the industry and finally, involving so many millions upon millions of dollars, were facts unknown to those responsible for the conduct of the corporation." The president of the parent Westinghouse corpora-

tion has candidly acknowledged a serious failure in corporate leadership.

Counterbalancing these factors, it is fair to say on the facts before us that the parent company's leaders are and have been responsible for the corporation's broadcasting activities. As the majority's findings show, the most important officers of the parent company sit on the board of the broadcasting subsidiary and are kept closely informed concerning the activities and plans of operating personnel. Testimony in another proceeding shows that basic decisions concerning network relationships, purchase or sale of stations and overall budget are explicitly discussed with or made by these officials of the parent. (Docket No. 12782, Tr. 2845-7, 2929-30.)

Weighing these circumstances, I think the Westinghouse Broadcasting record does reflect the attitudes of those who control the parent company and can be relied upon in assessing future performance. Given the unquestionably superior quality of that record, I think it reasonable to renew the broadcasting licenses, notwithstanding the company's misconduct in other fields. Certainly the corporation is entitled to an opportunity to demonstrate in practice that its career as a serious violator of the antitrust laws is over.

But I would not let the matter rest with a warning that it will be reconsidered if comparable misconduct again occurs. We have reasons both to trust and doubt Westinghouse. For these reasons, we should review this matter on our own motion in twelve months, to test our present conclusions as to the company's responsibility against further experience. The majority's order provides for no such examination; instead it relegates consideration of future renewals of Westinghouse broadcasting licenses to the normal processes. These, however, present the licenses of Westinghouse stations in different parts of the country for consideration at different times, depending upon the renewal dates set for stations in their respective geographic regions. Thus, no present basis for an overall review of the company's responsibility on our own motion is provided.

To this extent, I must dissent. We too have responsibilities under the law which cannot be abdicated or left to be discharged only when a licensee's gross misconduct raises questions that cannot be ignored.

DISSENTING STATEMENT OF COMMISSIONER ROBERT T. BARTLEY

I dissent to the majority opinion and vote for an evidentiary hearing on the above-captioned Westinghouse applications.

I think it is of vital importance to the Commission that a determination be made on the record as to who has ultimate and definitive responsibility for the broadcast stations, Westinghouse Electric Company or its wholly-owned Westinghouse Broadcasting Companies. Either Westinghouse Electric has this responsibility and its antitrust record is of serious import, both as to past conduct and as to whether such activity may creep into the broadcast operations; or, Westinghouse Electric does not have this responsibility and serious questions are raised as to the extent of its delegation to subordinate operating officials. Accordingly, I believe the record should include a searching inquiry into what extent decisions by officials of the Westinghouse Broadcasting Companies are, or have been, changed or over-ruled by Westinghouse Electric. It is imperative, I think, that a crystal clear showing be made as to whom the Commission can look for implementation and execution of Westinghouse station policies.

CONCURRING STATEMENT OF COMMISSIONER FREDERICK W. FORD

I concur in the decision but I would renew all Westinghouse applications now pending before the Commission for one year only.

FPC Examiner Says Proposed Southwest Gas Corporation-Nevada Gas Pipe Line Company Merger Would Be in the Public Interest*

Washington, D. C., February 19, 1962—Federal Power Commission Presiding Examiner Edward B. Marsh filed a decision today authorizing, as in the public interest, Southwest Gas Corporation, of Las Vegas, Nev., to acquire by merger the facilities of Nevada Natural Gas Pipe Line Company, of Las Vegas. The decision is subject to review by the Commission.

Southwest distributes natural gas at retail to some 40,000 customers in Arizona, California, and Nevada. Nevada Natural owns and operates two parallel transmission lines extending from the Arizona-Nevada border north through a portion of California to the Las Vegas area where it sells gas to Southwest for resale in Las Vegas, to California-Pacific Utilities Company for resale in Henderson, Nev., and to Boulder City, Nev., for resale in that city. Nevada Natural also sells gas directly to six industrial customers near Las Vegas.

The Arizona Corporation Commission on November 20, 1961, and the California Public Utilities Commission on November 21, authorized the proposed merger. Although the laws of Nevada do not require formal approval, Presiding Examiner Marsh said the testimony is that the Nevada Commission has given informal approval to the merger. *On January 12, 1962, the FPC ordered a formal hearing on the proposal specifically to assure that the policies and provisions of the anti-trust laws be taken into account.*

The policy of the anti-trust laws is to foster free competition, the examiner said, but competition is not always in all conditions in the public interest. There are times when

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* Federal Power Commission, Docket No. CP 62-110, Release No. 11,860, G 6471.

*monopoly, but regulated monopoly or a measure of controlled monopoly instead, is in the public interest, he said.**

Examiner Marsh said that the evidence in the present case shows that there is not now and has never been competition between the two companies; that the combined system would be considerably strengthened financially and more readily able to secure financing for obviously needed expansion in the public interest. Opportunities for improvements in load factor would increase, he said, and cost savings would be realized which, under regulation by the FPC, should ultimately be reflected in lower rates to consumers.

The basic and controlling question, Examiner Marsh said, is the impact of the proposed transaction upon consumers whose interests are subject to FPC protection and the interests of the public generally. Nevada Natural is a natural gas company subject to FPC jurisdiction but, prior to the consummation of the merger, Southwest has not been. Upon acquisition of Nevada Natural's facilities, Southwest will then be transporting natural gas in interstate commerce and will become subject to Commission regulation.

The Natural Gas Act places upon the FPC the duty and responsibility to see that all interstate natural gas rates, charges and classifications are just and reasonable and not unduly discriminatory or preferential, Examiner Marsh said. There is no evidence, he continued, that either Nevada Natural or Southwest will have placed themselves in a position less exposed or vulnerable to FPC regulation. Furthermore, he added, it is clear from the evidence that there will be no inflation in Southwest's accounts and, therefore, no basis on which the possibility of higher rates to consumers in the future may be predicated.

Southwest, as the surviving corporation, will continue all services presently being rendered by Nevada Natural at the latter's existing rates as filed with the FPC.

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* Emphasis supplied—Editor.

Parties to the proceedings have 20 days in which to file exceptions to the decision and the Commission has another 10 days after that to initiate a review on its own motion. If no exceptions are filed or review initiated by the FPC, the decision will become final at the end of this 30-day period.

BOOK REVIEWS

Monopoly on Wheels: Henry Ford and the Selden Automobile Patent, by William Greenleaf (Wayne State University Press, 1961, 302 pp. + XII).

Virtually since its inception, the American patent system has contained a basic inconsistency with the concept of a free-enterprise economy. Patent monopolies have been rationalized variously as being limited in scope and time; as not actually monopolistic like other forms because they are subject to competing alternatives and substitute goods and processes; as more than offsetting the monopoly element by the inventive contribution released; and as not depriving the public of anything it had previously possessed. Such explanations have been reiterated from time to time, especially when the patent system has been under particular stress or scrutiny. But they have hardly served to resolve the basic issue that persists.

In this richly detailed narrative, William Greenleaf provides an authoritative and comprehensive account of the attempt of certain auto makers and Eastern financiers to use the Selden patent as the foundation stone of a legal monopoly of the automobile industry. It is a noteworthy piece of work, not so much because of the careful manner in which the author develops the major critical turning points in the development of the modern automobile, or for the exposition of the role and career of Henry Ford in resisting the scheme, but rather for the interesting insights it affords into the vagaries of the American patent system.

The introductory sections of the book provide a detailed background of the preliminary research of various approaches tested in solving the problems of a motor-driven vehicle. The basic question to be resolved was not the creation of the essential elements of the automotive unit, but their combination into a light road vehicle with a small and reliable

self-contained power plant using a concentrated fuel that yielded long runs. Discussion of the successes and disappointments of the almost legendary figures Cugnot, Abbé Hautenfeuille, Murdock, Lenoir, Otto, Brayton, Marcus, Beau de Rochas, and others puts the inventors' problem in clear perspective and clarifies the very minor role played by Selden. It is of interest to note that in the case of auto experimentation, the true American pioneers, like their European counterparts, worked in complete ignorance of the work of each other.

Greenleaf shows how Selden's real interest was to secure a comprehensive patent covering every self-propelled road carriage with a gasoline motor, and as first applicant, he nearly succeeded. While Otto solved the 4-cycle engine, Daimler developed his air-cooled gasoline motor, and Duryea produced the first operable gasoline auto (1893), Selden, without having built any horseless carriage, patiently nursed his patent application until 1895. As the author points out, Selden's calculated delay was "the dalliance of a shrewd patent attorney . . . a consummate master of systemative and intentional delay."

In 1902, a full three years before the Selden vehicle, after a "slumbering life on paper," was finally summoned from the past and given material shape and form, George Day (President of Electric Vehicle Co.) conceived the idea of bringing manufacturers into a combination for protective as well as licensing purposes. This triggered a move by the independents to form a trade organization for dealing collectively with the Electric Vehicle Company. This led to negotiations culminating in the formation of the Association of Licensed Automobile Manufacturers, by which the independents were brought under the Selden banner and Day's vision became a reality.

The disingenuous nature of A.L.A.M. was disclosed by its view that "assemblers" were not eligible for membership, despite the fact that not one of the licensed manufacturers

had a self-sufficient plant! All in some degree assembled the parts and components purchased from outside suppliers. That Henry Ford's application for a Selden license was rejected by the A.L.A.M. because he was a lowly "assembler," the author tabs one of the exquisite ironies of American industrial history.

However, Henry Ford was not about to permit a rake-off from his car which he knew was the product of his own brain, and declared his now famous war on the Selden patent group. Ford had a reasoned view of invention as a matter of evolution and regarded the patent system as at best a necessary evil.

One of the illuminating aspects of Greenleaf's work is its disclosure of the policy of harassment followed by A.L.A.M. in attempting to validate its patent, a patent which still had not been adjudicated or pronounced valid. Nonetheless, the association tracked down alleged infringers through "patent sleuths," who scoured the streets in their hunt for "unlicensed" foreign automobiles, and had A.L.A.M. lawyers dispatch warning letters to owners notifying them of infringement. The tireless efforts of the A.L.A.M. in picking off "violators" was repeated many times over, and the association made big capital by grossly misleading publicity of these "victories."

An important turning point in the trade war was the 1908 decision of Judge George C. Holt,[1] regarding a contempt proceeding A.L.A.M. had instituted against a New York automobile tradesman, in which the judge observed that the Selden patent actually had never been conclusively litigated on its merits and had never been declared a pioneer patent. Later, in 1911, the Court of Appeals[2] unanimously ruled in

1 *Electric Vehicle Co. et al.* v. *De Dietrich Import Co. et al.*, 159 Fed. Rep. 492 (1908), cited at p. 181 in Greenleaf.

2 *Columbia Motor Car Co. et al.* v. *C. A. Duerr et al.*, 184 Fed. Rep. 893 (1911), cited at p. 226 in Greenleaf.

favor of Ford and the other defendants in the A.L.A.M. suit, stating, in effect, that Selden, in return for his letters patent, "had disclosed nothing of social value" and "from the point of view of public interest it were even better that the patent had never been granted."

In brief, the Selden patent is perhaps the leading example of the abuses fostered by the patent procedures existing at the time. Greenleaf's study shows very vividly that threats, intimidation, backed by financial power could bring about *de facto* recognition of a phony patent. The fact that Ford won out in this suit was more of a testimony to his genius, courage and confidence that he was legally and morally right, more so than built-in protections of the patent system. Greenleaf's documentation and analysis of the sequence of events ranks as an excellent case study of the historical abuses of the American patent system.

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Trade Regulation Reports, 5 volumes (Commerce Clearing House, Inc., Chicago, Illinois (1962). $180 for one year; $165 per year for two years).

Antitrust practitioners noted with interest the September 1961 announcement by the Commerce Clearing House that its Trade Regulation Report, now in its 47th year of publication, was assuming a new and expanded format.

Previously published in three basic volumes plus a "Current" Volume on new developments, the new series now contains five primary volumes. A weekly report provides the latest information in this fast changing field in place of semi-monthly reports heretofore distributed to subscribers. A concise summary accompanies each report to headline the notable events of the preceding week.

Each of the five volumes is devoted to particular antitrust topics. The set brings together and explains Federal antitrust trade practice and price laws, state antitrust laws, price discrimination, sales below cost and fair trade laws. Decisions, regulations, rulings and other pertinent data affecting trade regulations are also included to assure a reliable compilation as effectively organized as the complex nature of the material will permit.

Volume 1 includes a topical index, explanatory annotations to the basic federal and state statutes, and sections on monopoly, restraint and discrimination. The Antitrust Guide, designed to sort out the rules and clearly explain their relationship to business activities, is also included in this volume. Volume 2 covers Fair Trade, Misrepresentation, Labeling, and Antitrust Suits; the latter subject being subdivided into Department of Justice and state enforcement and procedure, and Private Antitrust or "treble damage" suits. Volume 3 concerns itself with FTC Procedure, Rulings, Dockets of Complaints, and a list of respondents in FTC complaints from 1960-1961, as well as respondents in FTC stipulations from 1930-1961. Volume 4 deals with the text of the state and

federal antitrust laws and the FTC Trade Practice Rules promulgated for particular industries. Volume 5 carries the Cumulative Index and a new feature, the Current Comment section, which rounds out the Reporter by exploring and analyzing new trends and noteworthy developments in antitrust and trade regulation law and indicating how these fit into the overall regulation picture.

Editorial annotations topically and alphabetically arranged with captions set forth in capsule form the salient rules, statutes and cases in a given area and aid in understanding antitrust and business practice rules. The increasing trend toward overlapping and interplay of the various Federal antitrust laws make these explanatory compilations a useful device in minimizing the time spent on initial research by the antitrust lawyers and are particularly valuable to business executives, accountants, trade associations, advertising agencies and others whose business affairs require a basic understanding of the antitrust laws.

While conceding the general excellence of these Trade Regulation Reports and giving full recognition to the difficulties involved in collating the enormous mass of material which comprises the antitrust laws, this reviewer believes that there are several additions which would enhance their value. For example, all new antitrust consent decrees in United States antitrust actions are reported in full text, but why have the equally valuable litigated decrees not been collected and reported, although they are presently generally unavailable unless they are built into the opinion?

It would also be helpful if CCH would utilize where possible, the official and national reporter citations to the Court decisions which appear along with consent decrees and opinions of the Attorney General in the annual bound Trade Cases. The present system of keying decisions basically to citations in the Trade Regulations Reporter series is, of course, of great value, but research could be more effectively implemented if the official and national reporter case citation were also given.

The annual cost which includes the five basic volumes, the weekly report, and the annual Trade Cases appears to be a reasonable price for a valuable service, which is essential to the antitrust practitioner and beneficial to laymen with an interest in trade regulation.

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